The Purchase and Sale Agreement
The Seller's View[1]

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Introduction

What is a Seller's viewpoint in an oil and gas properties purchase and sale agreement? The seller wants to sell only those properties that it feels has been given adequate value in buyer's offered purchase price, to get his money as soon as possible (with few, and preferably no, reductions from the purchase price offered), and to be left with few, and preferably no, continuing obligations and/or liabilities. "Here are the keys, gimme my money, don't call me"--that's a little simplistic, but not by much.

As a part of this presentation, an example purchase and sale contract (purchase and sale contracts will be referred to herein as PSAs) has been prepared and is included as a part of these materials. Although prepared for this presentation to highlight issues of concern to seller, it is also like a "preferred draft" PSA that a seller might furnish to a buyer, or place in a data room. This example PSA is **NOT** intended to be a form. Nor will it highlight every issue of concern to a seller. It is just an example to focus this presentation and highlight issues covered by this presentation. Every deal is different. Every seller (and buyer) has different motivations, concerns, and personality - which will often vary from deal to deal even with the same seller.

In addition to the example PSA, examples of possible alternative language have been provided (referred to herein as Riders). As with the PSA, these Riders are provided only to focus the presentation, and to highlight some issues. They are also **NOT** intended to be a form, nor are they exhaustive-there are many issues, many ways to resolve issues, and many ways to write up those resolutions. Hopefully, though, between the example PSA, the Riders, and the text below, this presentation will provoke some thought, offer some ideas, and otherwise be helpful.

Having offered all that as a preface, let's get started through the PSA.

The Parties

That seems pretty simple, and usually it is. There is a seller and a buyer. They are oil industry entities of some substance who are buying and selling a group of properties. In many cases, that is the

case-and in the example PSA this is assumed to be the case. But there are other situations, and here are a few thoughts on other situations.

Multiple Sellers. Sometimes there is a group of Sellers. Typically (not always) one is the ringleader, and typically (not always) it is the operator. In some cases, the non-operators will know little about the properties and their operation.

Multiple sellers probably will not want to be responsible for each other. This manifests itself primarily in the areas of representations and indemnities. One party will not want to represent things about another party or be responsible (through representations, indemnities or otherwise) for another party's interest in properties. Non-operators may not want to make operational representations (or indemnities) at all, feeling that they have little knowledge of, or control over, such matters. The Rider titled "**Several Liability Rider**" is a simplistic approach to the "don't want to be responsible for any other seller or his properties" issue (in the example PSA, this would be added to the miscellaneous provisions). Obviously, this can be handled in a more elaborate manner, but this may capture the essence of the concept.

Although really the buyer's point, the buyer may not want to deal with each and every seller on a day to day basis in administering the contract-most notably in due diligence/curative/ price adjustment and accounting issues. The Rider titled "**Seller's Representative Rider**" provides some language to deal with this issue (in the example PSA, this would be added to the miscellaneous provisions). Sometimes all sellers will happily to let one person take care of all these administrative matters, and sometimes they will want input. This must be considered and dealt with, but it is a separate issue. The buyer probably doesn't really care if all sellers want input or not, he just doesn't want to deal with a room full of people on every title defect, accounting adjustment, or other issue. There is also potential for conflicts among the sellers, particularly where they do not each own a uniform interest in all properties. For example, agreeing on allocated values for title defect purposes can be an adventure with non-uniform ownership. A seller will assert that the properties in which he has a bigger relative interest are worth more than the allocation indicates and, vice versa, those in which he has a smaller relative interest, or no interest, are worth less. If a seller's representative is used, a person acting as agent would presumably have some duties to the parties for whom he is acting as agent, such issue is beyond the scope of this presentation.

Different Types of Sellers. If the seller is not an "industry" player, or if the properties are all non-operated, the seller will probably be even more reluctant than usual to provide representations, indemnities, and other entangling agreements with potential lingering liability.

Less Substantial Sellers or Buyers. Obvious cases are undercapitalized buyers or sellers, financially distressed sellers, sellers going out of business, and single purpose entity buyers (formed just to purchase the package of properties, either as freestanding entities or as a subsidiary of another entity). Where these situations exist, consideration must be given to the fact that agreements of the "less substantial" party may not, as a practical matter, be worth much. Perhaps the most important point is to know the other party and be aware when situations like this present themselves. As a seller, getting the

money may be enough if there are few, if any, ongoing obligations from the buyer that seller actually relies upon. However, if there are ongoing obligations that need substance, a third party guarantee, parent guarantee, or escrowing some additional funds may be something seller should look at.

What's Being Sold

Before the portion of the PSA describing the assets being sold can be drafted, the parties need to agree upon what exactly is being sold. Is the seller disposing of everything in an area? If so, very broad descriptions, possibly including a "catch all" clause, could be appropriate. If not, more restrictive descriptions are appropriate. Is seller disposing of only very specific properties, perhaps even keeping some of the lands and depths covered by leases included in the sale, for which buyer has given no or less than satisfactory value either because they are non-producing and represent, at best, only proved undeveloped locations or for some other reason? Is the deal somewhere in between? Are minerals and royalties included? Are overrides included? Are there other significant assets included-a fieldwide gathering system, a field office, etc.-that need to be dealt with?

Selling Specific Properties/the Example PSA. The example PSA assumes that the properties being sold are a very tightly described group of properties being leasehold only and limited as to area and depth. In this scenario, the seller retains all lands and depths (covered by the described leases) which are not described in Exhibit A to the PSA, retains any undescribed leases, and retains all mineral and non-leasehold rights. In a separate reservation, near the end of this section of the PSA, the seller also retains all existing overrides and other non-costbearing interests (even those that may later convert to working interests). To be certain there is no question about minerals and royalties being retained, the reservation also includes such interests. The example Exhibit A to the PSA shows that some level of detail is required in order to implement a scenario where leasehold being sold is limited to certain lands and depths. An additional limitation would be to limit the properties being sold to specific undivided interests in the leases, in which case the seller would retain the remaining interest in the leases including the lands and depths described. This additional limitation (which is rarely seen) is not used in the example PSA. The example PSA also assumes no substantial off lease assets, such as gathering systems, field offices, etc, are included in the assets being sold, and hence does not describe any such assets.

In theory, the seller would always want tightly drawn descriptions of what is being sold to ensure he is only selling what he is getting paid for. However, as a practical matter, in many cases the seller opts for somewhat less restrictive descriptions, ending up conveying all interests in the leases in order to avoid the extra complexity, and time and expense, of preparing (and checking) the Exhibit A in the level of detail required to effectuate a restrictive description selling everything he has in an area. If that is done, Exhibit A can be simpler by describing the leases with lessor, lessee, date, and recording data type information (but no description of lands and depths) which should be relatively easy to generate from computerized land data (of course, the language appearing in Section 1(a) of the PSA which limits what is being sold - "insofar as", etc. - would need to be deleted too if this course is taken. A mix can be done by using one paragraph to handle leases sold without limits (leases described in say an Exhibit A-1) and using a separate paragraph for more restrictive descriptions of other leases

(employing say an Exhibit A-2). In addition, land descriptions may need to be added if the same exhibit is used for the recorded conveyance document in states where land descriptions must be shown for recording.

Selling Out of an Area. If the seller is selling everything he has in an area, somewhat simpler descriptive language can be used in the body of the PSA (dropping the "insofar as" language at the end of Section 1(a), as discussed above, with the Exhibit A being simpler), and the parties may want to employ a catch all (discussed below).

Catch All Clauses. Catch all clauses can be useful in a number of contexts. Three example "**Catch All**" clauses are attached-as written, each assumes it would be added to the example PSA as a new Subsection 1(b), with all following subsections renumbered and with each following subsection referring to both subsection (a) and (b) (or subsection (a), (b) and (c)) where it now refers just to subsection (a) (or (a) and (b)). The first catch-all example is fairly narrow in terms of land area covered, extending only to lands described on Exhibit A, or in the leases or other instruments described on Exhibit A. (Note: Be careful with the phrase "described in leases or other instruments described in Exhibit A"-seller should make sure there are no instruments (or leases for that matter) described in Exhibit A that cover vast areas that could include lands not part of the intended catch all area.) This first example could be used in a situation where the purpose of the catch all was just to pick up interests that were inadvertently omitted from the exhibit such as leases covering some of the same lands as other leases that are described in the exhibit. The third catch-all example is broader and designed more for a situation where seller is disposing of all of its assets in a geographic area. The first and third examples also assume minerals and overrides are being sold, but this does not have to be the case. The second catch-all example only includes leasehold. (Note: If overrides and minerals are intended to be excluded, they probably need to be the subject of an express exclusion - see discussion below.) To be effective, a catch-all clause covering an area must contain a valid legal description of the area (or, as in the first and second examples, a reference to instruments containing valid descriptions)-if that area is an entire county or counties, or even a state, it can be pretty easy, otherwise references such as to sections, townships and ranges (or parts thereof) will be needed (and harder to do in states like Texas which aren't "regular section country").

Catch alls are not always effective. The Texas courts will look to the intent of the parties in addition to the catch all language in the conveyance. The Texas Court of Civil Appeals, in the case of *Texas Consolidated Oils v. Bartels*[2], recognized the general rule in stating "It has long been the rule that a deed purporting to convey all lands owned by the grantor in the State or in a named county is sufficient description to effect a conveyance." In that case, the court upheld a grant of "all [Grantor's] right, title and interest, legal and equitable, in and to ... [the following property]... located in the United States of America... oil, gas and mining leases... any of which are located within the states of...Texas." However, a recent Texas Supreme Court decision held that a conveyance with catch all language can be ambiguous and the parties intent will be used to decide its effect. In the *J Hiram Moore Ltd v.*

[2]270 S.W.2d 708, 711 (Tex. App. - Eastland 1954).

Greer, conveyance specifically described a tract to be conveyed while another portion of the conveyance contained a catch all grant for all of grantor's royalty and overriding royalty interests. The grantee claimed on title to properties in the county which were not specifically referenced in the conveyance. Grantor responded that the intent was never to convey all of her interest in the county. The court agreed and held that such catch all language was not intended to convey large, parcels of property not specifically described. In reaching the conclusion that a deed is ambiguous, the court will ascertain the parties' intent based on (1) the amount of acreage specifically described vs. the acreage claimed under the catch all provisions, and (2) the purchase price in relation to all of the property.

Arkansas courts have also upheld the use of catch all language as prove mg notice to third parties . Louisiana will uphold the catch all language between the parties only but such language will not serve as adequate notice to third parties. Catch all provisions generally do not work in states with tract index recording statutes. In tract index states, the official records are kept by property description, not grantor/grantee name, making it impossible to record a catch all conveyance to place other parties on notice.

Related Personalty, Permits, Easements, Equipment, Facilities, Etc. Section 1(d) of the example PSA deals with the related personalty, permits, easements, and other similar items (referred to herein as PPE) in general terms, as is most often the case. The PSA attempts to restrict the PPE conveyed to that part thereof which is related to the leasehold being conveyed-which is a nuance the seller should want. As to equipment and facilities, the example PSA is restricted to those "located on the Properties." If there are facilities located off the properties, this may require adjustment. A seller should always ask himself if there is something unusual that calls for a different approach.

Other Assets. Often times there are other assets that are included in the transaction, perhaps most common being gathering systems, or field offices and other structures, or fee surface tracts. These sometimes get overlooked. A buyer may want separate descriptions of these items and possibly a separate conveyance. Seller has some interest in this subject--in providing accurate descriptions of these assets--as a general description may sweep up things that were not intended.

Geophysical and Other Data. Section 11(b)(i) of the example PSA assumes data is not being conveyed and specifically excludes such data (it is best to expressly address data), but in many cases it is included. An important point to remember is that just describing data among the assets being conveyed is, in many cases, not the end of it. In many cases data is not readily transferable, there may be license issues, confidentiality issues, and other problems. It is beyond the scope of this presentation to get into those matters, but if data is being transferred, particularly if it is of any significance, the parties need to be mindful of these matters.

Reserving Minerals, etc. As noted above, the example PSA assumes minerals, royalties and overrides are not being conveyed. The example PSA includes an express reservation of these items. While theoretically fee interests (fee minerals and royalties) are not included in a contract or conveyance that just describes leases (they aren't carved out of the leasehold), it is best to expressly reserve them. Overrides could get swept up as part of a conveyance of all interest in leases, since they are created out

of the leasehold-so they should be expressly reserved. A thorough PSA should also expressly address overrides that convert or are potentially convertible to working interests.

The Reserved Override Tax Trap. Sometimes seller will want to create and reserve a new overriding royalty out of the leasehold being conveyed-not just keep previously created overrides. This reservation can be done, but seller should be aware that it alters the usual tax treatment of the sale. If such a reservation is made, the sale will be taxed as a sublease.' The bonus, cash and other consideration paid to the "lessor" upon creation of this sublease is ordinary income,' taxable at ordinary income tax rates, not capital gain rates. Further, seller will not be able to reduce the taxable amount by any basis he has in the properties, so the taxable amount will likely be higher too. The benefit of keeping a override may be worth the additional tax to be paid, but many times it is not. A seller wishing to reserve an override should be aware of this tax treatment and carefully consider its effect before deciding whether to reserve an override.

Purchase Price and Related Issues.

The example PSA assumes that there is a flat purchase price (subject to adjustment for title, other defects, and accounting adjustments to reconcile revenues and expenses to the Effective Date), paid in full at closing (with some post-closing accounting adjustments), with no adjustments for contingencies such as future changes in product prices. The example PSA also assumes that the buyer will pay a deposit to the seller at the time the PSA is signed. This deposit will be credited, without interest, against the amount payable at closing. The PSA also provides what happens to the deposit if the deal falls through. This is about as straightforward as it gets -- obviously there are variations.

Deposit vs Escrow, Related Issues. Of course, buyer would prefer not to put up any money at the PSA signing, as a deposit or otherwise. But if buyer agrees to, it may prefer that a third party hold these funds. In that case, the parties should identify the escrow agent, and obtain the form of Escrow Agreement required by agent (parties can draft an escrow agreement, but as a practical matter many escrow agents are very fond of using their own forms). The Rider titled "**Earnest Money Rider**" provides the escrow and related details in the PSA. Issues to consider include: how will the agent's fee be borne (typically 50/50, although some sellers will say, "you wanted an escrow agent, you pay him"), if and how the funds will be invested while held by the escrow agent (typically very conservative, cash or near cash), what becomes of any interest or other earnings on the funds (who gets the benefit and whether such answer changes if the deal does not close), how are funds handled if the deal doesn't close, and what specific documentation, etc. will the agent require for the agent to disburse funds. This last one may be the most tricky, as many agents will try to disburse only on joint instructions from both parties while, in a case where a deal fails, the party entitled to the funds under the PSA will want the funds paid to it without approval from the other party.

Even if a deposit is done rather than an escrow, how funds are disbursed if the deal fails to close will be an issue. Interest may be an issue with a deposit-buyer may feel that, if the deal closes, it should get credit at closing not just for the deposit amount, but an additional amount representing interest on the

deposit at some agreed rate, particularly if the deposit is large and/or the time from PSA signing to closing is significant. The example PSA, being written from a seller's point of view, does not provide for such interest.

There are some issues regarding use of a deposit or earnest money as, in effect, liquidated damages that should be considered. Not all liquidated damages provisions will be upheld if challenged in a court of law. Case law is fact specific and inconsistent on upholding an agreement for liquidated damages and courts are not inclined to enforce such agreement if it is in excess of the loss actually suffered and constitutes a penalty.' Liquidated damages are pre-agreed damages between the parties as compensation for breach of contract because the actual harm would be impossible or very difficult to estimate! The terminology used by the parties has little bearing. A "penalty" in the agreement has been held to be liquidated damages9, or something referred to as a "liquidated damages" has been held to be a penalty10. Liquidated damages are appropriate if the injuries caused by a potential breach would be difficult to estimate at the time the contract is entered into by the parties and such estimate does not greatly exceed the injury that might be suffered.1' Liquidated damages are commonly used for oil and gas transactions including royalty sales12 or sales of oil and gas interests because the value of such interests and potential injuries relating thereto are hard to estimate13 such as with consumer goods.

Future Price Adjustments. Sometimes the parties will agree to future adjustments in the purchase price. Perhaps most commonly, these are to deal with situations where there is high volatility in product pricing (making it hard for buyer and seller to agree on a purchase price because they have used significantly different pricing assumptions in valuing the property) or where there is disagreement over the quantity of certain reserves, most commonly reserves other than proved developed producing reserves. There are many possibilities in dealing with disagreements over reserve quantities and they can be quite fact specific, and provisions covering future adjustments in the purchase price to deal with these disagreements are relatively rarely seen in PSAs. As a result, this presentation will not discuss reserve quantity disagreements, other than to note the possibility and to suggest that the best solution may well be to exclude the disputed reserves, if possible.

Future price adjustments to deal with product price volatility often use published pricing data as a reference point, and use, as a basis for adjustment, a comparison of prices at one time (typically contract signing) to prices at another time. Such future price adjustments take into account several factors. For the first factor, the parties must agree upon a beginning number. The parties could just agree on a figure, it wouldn't have to be based on published data, with the future comparative number being based on published data. The second factor in such a scheme is to find an acceptable, agreed upon published source and adequately identify it. The third factor is establishing the time frame to be used. The fourth factor is whether the adjustment only be made one way (for example, if prices go up, seller gets paid more; if they go down, there is no refund), or will it be made both ways. While a one way only adjustment can be appealing to the seller on its face, if the result is a lower initial purchase price offered by Buyer to account for such risk, it may not always end up with the highest final purchase price being paid to seller. A fifth factor is the amount of the adjustment. Will the adjustment reflect the full product price variation or only
a portion thereof. For example, if the later price is 120% of the initial reference price, is the seller owed 20% more purchase price, or is the adjustment only a proportion thereof, such as 50% of such increase,

or 10%? Will there be a cap on any such adjustment, and if so, what will it be? Additional factors to consider are the tax implications, and whether liens and security interests will be retained to secure any future payment by buyer, or if funds will be escrowed to secure future payment by either buyer or seller.

Something to consider in agreeing to such an adjustment mechanism is that it is, by nature, imprecise. In a simplistic example, if product prices rise and expenses don't (and those assumptions were factored into an evaluation report on the properties), reserve volumes will actually rise too as the point at which a property becomes uneconomic is pushed out farther. In that scenario, the actual value increase would be more than the price increase. And there are other variables that affect value too. Some would say this suggests that a better way to do this is to rerun an agreed engineering report, using agreed parameters (a challenge perhaps to come up with). Although logical, there might still be imprecision on a new engineering report and there will be a lot of work in agreeing on methodology. These types of adjustments (whether for price or reserves) may be a way to reach a meeting of the minds and get a deal done, but it is not an exact science.

Purchase Price Paid in Installments. The example PSA assumes purchase price is paid in full at closing, but parties could agree to an installment sale. If that occurs, there will at least be tax issues and issues regarding liens and security interests to secure payment. Installment sales are not common and beyond the scope of this presentation.

Seller's Representations.

Consistent with its desire to have as few obligations as possibly-beyond handing over the properties-seller will want to make as few representations as possible, and to limit those it does make to the greatest degree possible. The example PSA contains five pretty basic seller representations (referred to herein as Basic Representations) (which happen to be the kind of representations the seller will want from buyer), plus a limited special warranty of title which many sellers will seek to avoid. This is also consistent with a view by seller, discussed below, that seller representations work with the due diligence/"Defect" process to help buyer assure itself that it is getting what it thinks it is paying for, and that, from the seller's point of view, most of that "assuring" needs to be done through due diligence and not through representations. In fact, seller may actively pursue a negotiating strategy that argues that buyer can have extensive due diligence rights but only very limited representations (the example PSA assumes this strategy was followed, at least to a degree)-this is somewhat easier to do if, from the beginning (i.e., from the first contact, from the data room stage, etc.), seller has made it clear that this will be a "satisfy yourself', "as is, where is" deal, largely without representations. If buyer has a different understanding of the nature of the deal, a long and arduous discussion of representations may well ensue.

What Are Seller's Representations For? Conceptually, seller representations work with due diligence to help buyer assure itself that it is getting what it thinks it is paying for. Buyer may well prefer to be covered both by representations and by due diligence, but seller will resist that, arguing that those things buyer can assure itself about through due diligence, which to seller is most if not everything,

should not be the subject of representations. If that concept is followed to a logical conclusion, then it should be noted that buyer can argue that, to the extent representations are curtailed, issues that could give rise to "Defects" as part of the due diligence process should be expanded. To the extent the parameters of what constitutes a "Defect" can be adequately defined (so as to prevent the Defect process from becoming a free for all-more discussion of that subject later), this is not necessarily a bad result for seller.

Reducing Representation Obligations. There are a number of ways to reduce seller's obligations for representations:

Limiting wording: In addition to the Basic Representations already included in the example PSA, the Rider titled **Additional Representations** contains a few additional representations. These are tightly drafted as seller would desire. A few drafting suggestions in that regard:

(a) Preferably, the representation should be a representation of readily-ascertainable facts, not generalities (such as "seller has not received written notice of any violations of environmental laws" as opposed to "the properties are compliant with all laws").

(b) The subject matter should be limited where possible. The special warranty of title in the example PSA is limited to producing zones and identified proved undeveloped locations (and target formations). This limitation shows up, as it logically should, in a number of the possible additional representation riders discussed below. Why? Because this is probably all buyer gave value to, so buyer should not need a broader representation that allows more room for breaches (through error, if for no other reason) and mischief. Other example limitations include (i) the Additional Representations rider on environmental laws, and (ii) where seller limits some representations to only properties operated by it.

(c) A knowledge standard should be imparted. Seller should only be responsible for what it knows about-and that standard should be limited in such a way that seller can readily ascertain if knowledge exists. For example, if you just say "seller's knowledge", that could possibly include one of seller's pumpers who might know about something he didn't share with higher-ups (or actually concealed because it reflected badly on him). The people whose knowledge is attributable to seller should be a finite group, preferably identified by name (although classification may work-such as seller's executive officers located at [fill in home office address]), who can be quizzed by seller about the representations before they are signed off on (if you are on the receiving end of a representation limited like this, you need to be as careful as the party giving it about who is on the list, ask questions and be sure the right people are on it). Knowledge can be limited to "actual knowledge, without investigation"-so as to eliminate, to the extent possible, "should have known" or "could have known" or even "if he'd asked he would

have known". A limitation to situations where seller has received written notification of something constituting a breach is in a way a knowledge qualifier, although including both that concept and "to seller's knowledge", if possible, is even better (the wayward pumper mentioned above may have been handed a letter from an irate landowner, and thus, absent a "to seller's knowledge" qualifier, seller may be found to have received a written notice). There are some interesting cases on what "knowledge" means which you may want to be familiar with if you use that qualifier. The meaning of the term "knowledge" varies greatly across courts and areas of law. Criminal law is generally very limited to require actual knowledge-intent always being an important element of a crime. The bankruptcy courts generally hold "knowledge" to be based on facts that would lead a reasonable person to believe such item existed with no duty of inquiry required. All of these areas are bound by statutory law. The Supreme Court of North Dakota held that the "knowledge" was stronger than "best knowledge".14 In this case, the statute for service by publication referenced "best knowledge" but the actual summons published only contained "knowledge". The defendant claimed such notice to be defective. The court held "best knowledge" to be a comparative standard which can be met even if the party has other knowledge, information and belief. The court held "best knowledge" to be less restrictive than "knowledge" which is a positive statement.15 This is support that "best knowledge" is not necessarily accurate or complete, but sufficient to draw a conclusion. However, in Texas, a representation "to the best of Seller's knowledge" requires actual knowledge and did not impose any duty of inquiry.16 Outside of these general areas bound by statutory law and based on the facts of the case, the courts' interpretation of the term "knowledge" varies from actual to constructive knowledge.

(d) A "materiality" standard can be employed. Various renditions of this are possible, from just using the word "material" to having a defined term such a "Material Adverse Effect". For the seller, the broadest scope of materiality is desirable, that probably being that the item must be material in light of the entire transaction taken as a whole, so as to eliminate as many smaller issues as possible.

(e) Except things that are disclosed (use a disclosure schedule exhibit, so as not to clutter up the text), and, in general, disclose liberally.

(f) The subject matter of the representation needs to be important to the deal. If some or all of the subject matter of the representation has little relevance to the deal (and to how buyer decided to buy the properties and at what price), the representation should be resisted or the subject matter changed or described more narrowly (see again the special warranty of title in the example PSA).

(g) Resist representing things that can be ascertained through due diligence (see above discussion about relationship between due diligence and representations).

(h) Before finally signing off on a set of representations, do some due diligence to be as sure as it can that the representations can accurately be made. Of course some (maybe many) buyers will say, "I don't care if you can verify that a representation is true, representations allocate risk". The theory being that seller needs to assure buyer with respect to certain matters, even if it can't be sure what it is saying is true, with the consequence being that seller retains responsibility for those matters. Seller will want to resist these situations to the extent possible, and should avoid making any representations, or other assurances, to buyer where it knows the facts buyer is wanting assurance on are not accurate.

Limiting survival: More on this later (in the discussion of Section 17 of the example PSA), but, generally, limiting the survival of representations is an effective risk reducer for seller, since the shorter the period of time that seller has liability, the better (don't want to give any "5 year bumper to bumper" warranties). At least there is certainty at the end of that period that a contingent liability is gone. Seller would really like to limit survival of all representations (making all expire at closing except the Basic Representations), and possibly special warranty of title, given that title warranties are often ongoing.

Limiting Remedies. The Rider titled **Limitation of Remedies** provides that, at seller's election, a breach of representation, where the breach relates to some, but less than all, properties, will be treated like a "Defect" and be subject to the "Defect" procedure (even if representations survive closing and a breach surfaces after the "Defect" process is concluded) (this is shown as alternative language, as there is less need for such a limitation if representations are as limited in number and scope as in the example PSA). This Rider has several liability limiting effects: it limits the dollar value of a breach to no more than the value assigned to the affected property or properties as established for "Defect" purposes, it imposes all the deductibles, etc. that are part of the "Defect" valuation process which generally reduces the dollar value of a breach, and it allows seller the right to keep or take back properties rather than just accept a price reduction where it feels the reduction is too extreme (and in an extreme case could lead to an unwind of the deal if the total value of breaches and "Defects" exceeds the amount specified in conditions to closing-see Section 10 of the PSA). Obviously, some or all of these limits could be written up separately, without referring to the "Defect" process. At the very least, seller may want to provide that damages for breach of a representation shall never exceed the value assigned to the properties affected by the breach for "Defect" purposes.

On the other hand, some PSAs will contain language making the breach of a representation an item for which seller indemnifies buyer. Sellers should not agree to such provisions lightly, as an obligation to indemnify may result in greater liability than the liability that may exist for breach of a representation.

Disclaimers of Representations. The example PSA contains extensive disclaimers. Some are UCC related ("merchantability", etc.) Others relate to environmental and other property condition issues and the "where is, as is" nature of the sale. Still others relate to data which may have been exchanged. More disclaimers are provided in Section 6(a)(i) of example PSA. These disclaimers are important since, even if representations are added to the few set out in the example PSA (and the disclaimer language excludes the express representations from the disclaimer), most oil and gas property sales come with a lot of things that are not represented and it helps to be as clear about what is not being represented.

Taking data as an example, oftentimes seller will have an engineering report, as well as other data, that buyer may consider in making its own evaluation of the properties and making its purchase, and purchase price, decision. This exchange of data is important to getting the deal done, but it is the buyer's own evaluation that it should rely on, not a representation from seller. If seller was concerned that it was warranting, say, its engineering report, it might not be as willing to offer it. A similar situation arises with title files and other title data. Buyer needs access to this information for due diligence, but seller cannot warrant accuracy of every item in the reams of paper in its files.

Typically oil and gas properties are sold "Where is, as is" (subject perhaps to some specific representations), so this status also needs to be spelled out to avoid any implications to the contrary. There are some interesting cases in this area. First, "where is, as is" language may be ignored as boilerplate if it is not an important part of the basis of the bargain. In *Prudential Ins. Co. of America v. Jefferson Assoc., Ltd.*'', the Texas Supreme Court upheld a "where is, as is" clause and declared that the buyer take nothing on its claim for damages to the purchased building. In this case, the buyer discovered asbestos in the purchased building and sued the seller based on the Texas Deceptive Trade Practices Act, fraud, negligence, and a breach of good faith and fair dealing duty. The seller relied on the "where is, as is" disclaimer. The court rejected all of the buyer's arguments and reasoned that "[b]y agreeing to purchase something "as is', a buyer agrees to make his own appraisal of the bargain and to accept the risk that he may be wrong."18 However, the court noted that it would not prevent recovery on a seller's fraudulent misrepresentation or information concealment or if seller obstructs buyer's inspection.19 An example of such exception to the general rule of the "where is, as is" disclaimers being upheld is found in Nelson v. Najin2° wherein the Texas Court of Appeals upheld disregarding the "where is, as is" disclaimer in a conveyance when the seller of a gas station failed to disclose the existence of an underground waste oil tank to the buyer.

Second, courts have limited the application of the "where is, as is" disclaimer to certain claims. In which case, seller may still be liable for contribution under CERCLA.21 Seller should protect itself on this type of liability through the use of indemnity provisions.

The example PSA disclaimers do not disclaim any title warranty because the example contains a limited title warranty. It does contain a general disclaimer of warranties not expressly stated, but doesn't specifically mention title. If it did not contain a limited title warranty, disclaimers would likely include an express title warranty disclaimer. Also, the disclaimer excludes representations which may be in the

conveyance in the example PSA (a title warranty is included in the conveyance), but many times there are no such warranties and no need for this reference.

Meshing Representations with Indemnities and Other Provisions. The relationship between seller's representations with other parts of the PSA is an important matter to keep in mind. Representations by seller may create obligations that potentially conflict with assumptions of liabilities by buyer in the assumption and indemnifications section. Survival provisions can come into play, too. If buyer assumes liability for something that might have otherwise been a seller liability (say liabilities arising out of the condition of the properties on the Effective Date, as buyer does in the example PSA), to the extent seller represents no such liabilities exist (as in the additional representation rider relating to environmental laws, at least as to seller receiving written notice of something), an inherent conflict exists. And this may be intentional - buyer may, in this example, be willing to assume such liabilities, but want at least breach of representation liability on seller's part in the limited case where notice of a problem had been received by seller. But it may not be intentional-say seller had given a much broader environmental representation (that all environmental laws were complied with), then seller may inadvertently lose much of the benefit of buyer's assumption. If a breach of representation exists based on an unknown adverse condition on the property which would then be in conflict with such assumption, survival can also come into play. If seller's representations expired on or before the date on which buyer assumed such liabilities, there would be no conflict. Defects come into play, too -- certainly in seller's view, an issue that may be detected should not constitute a breach of representation after the defect notification date. There are many complexities that seller should be aware of, and try to avoid, to reduce and eliminate conflicts between different parts on the PSA.

Discussing Some of the Example Seller Representations.

Section 4(a)(iii). Note the exclusion of preferential rights, consents, and uniform interest provisions in this Section 4(a)(iii). The PSA later (Section 6(c)) deals with preferential rights and consents in a specific manner recognizing that there is some likelihood that some will be missed. It is better for seller if they are handled separately, and not swept up in a general representation. This treatment also more accurately reflects how these matters are usually handled as a practical matter. Uniform interest provisions are often ignored in practice, so there is no need for seller to get caught in a representation breach over them. (See concept (f) above - subject of representation should be important to the deal.)

Section (a)(v). This section utilizes a knowledge qualifier as part of the representation. This could also be revised for written notice qualifier instead or in addition to the knowledge qualifier.

Section 4(a)(vi). The title representation in this section is limited to a "by, through and under" "special" warranty, rather than a general warranty. As noted above, it is also tied to items buyer gave value to. Actually, keying this representation to specific revenue and expense decimals has some value for buyer, too, since arguably, if seller just warrants title to the "Properties", as defined in the example PSA, the warranty is ineffective since these items are defined as "seller's right, title and interest." Seller will never own less than its "right, title and interest", whatever that

is, and the stated numbers establish a standard for the warranty to apply to. Buyer may want to repeat this warranty in the conveyance. If so, Schedule I data will need to be included in the conveyance and, if included, the parties may want to provide it is not attached to recorded counterparts of the conveyance to avoid showing it to the world. Any survival limitations will need to be included in the conveyance. Seller should also limit the warranty to the real property interests which are the "Oil & Gas Properties" instead of the Properties.

Discussing Some of the Example Additional Seller Representations. Of course, seller would prefer not to add any representations, but attached are a few examples that might be considered. In any given situation, others might be added (as written or revised), and some of these might not be added, etc. Seller representations is a very fluid area, and very much the subject of negotiation. A few specific comments:

First three additional representations. These representations are matters that could affect the value of the properties but are not easily revealed in a review of files, and thus due diligence. Note that all are to some degree limited by knowledge, and the last two by materiality, but these limits could be expanded or contracted beyond this example. Buyer may argue that a "material" standard, on a "properties taken as a whole" basis (as these example representations are written), would pretty much destroy the applicable representations, since it is unlikely any one situation would meet that standard, and smaller levels of unanticipated situations still affect value. However, buyer might agree to a more restricted "materiality" standard.

Production marketing. Market sensitive and short term arrangements have been excluded as they are unlikely to affect value to any great degree. "Calls" that have been previously reserved in conveyances and farmouts have been excluded unless recently exercised. In older properties, "calls" were reserved with some frequency, and generally neither the holder of the call or the owner of the affected property has done a good job of keeping up with such calls. Thus, if these are not excluded, a possibility for a technical breach is created that, as a practical matter, does not affect value. The "knowledge" qualifier will sometimes provide protection when things are overlooked by seller.

Gas balancing. In most deals, particularly now, this is not an issue, but buyer may still request a representation that there are none. Represented figures are given an "as of" date since these figures will not be real time and may not even be very current on non-operated properties. Seller could make this representation just as "no imbalances exist" and except certain listed properties therefrom either due to knowledge of possible imbalances, or lack of knowledge of any kind, or seller could eliminate represented numbers just indicating there may be imbalances for certain properties to give buyer a lead as to where to pursue due diligence on imbalances. The example PSA rider is drafted for represented numbers. The seller's representation could also be further limited to "no 'overproduced' situations" since undisclosed "underproduced" positions would benefit buyer. The representation could also be drafted for an express "materiality" standard such that only imbalances over a certain volume are shown, creating a

little more certainty for both parties; this avoids the issue of broadness of a "materiality" standard, as discussed above.

Environmental Laws. Many buyers want a representation on this point, particularly if the assumption and indemnity sections of the PSA make them pick up, either at closing or later, responsibility for environmental matters regardless of whether they arose in whole or in part before the Effective Date. Where such an assumption and indemnification scheme is agreed to, seller needs to be particularly careful about its environmental representation to avoid losing all or a portion of the assumption and indemnity by buyer due to a breach of representation if something was overlooked. However, survival limitations may come into play such as if this representation expires at closing, it may not conflict with an assumption and indemnification by buyer, as discussed above.

As written, the environmental representation is quite narrow. Seller must have received written notice from the applicable government agency, not a private party, and the applicable persons whose "knowledge" is attributed to seller must know it. This could be drafted even more narrowly to apply to notices of violations of law only (as in Section 7(b)(v)), but the example was written so as to show what might be said beyond that. If the scope of representation is widened-say by eliminating the requirement for receipt of written notice--seller might consider adding a materiality limit on violations and/or properties affected. Buyer may resist a materiality limit on properties affected and argue that environmental liabilities can exceed property value, so materiality of property affected is irrelevant. As discussed above, if buyer assumes and indemnifies as to environmental matters, a more limited representation at least limits the instances where seller might reacquire some responsibility through breach of representation. Seller can argue that no representation is needed on this subject since environmental matters can be explored through due diligence. As with all example representations, this is just an example, and could be modified in many ways.

Comments on Other Representations Buyer May Request. The possibilities for requested representations are endless. Although this presentation doesn't claim to address them all, here are some comments on a few that might be requested by Buyer:

Compliance with all laws. This presentation suggests such representation be resisted because representations should be defined narrowly and only concern a matter important to the deal and of value to the properties. If needed, the Applicable Environmental Laws representation could be adapted into a "compliance with laws" representation by not limiting it to environmental laws and the above discussion on such representation would continue to apply. A seller would, of course, prefer the narrower representation limited to environmental law, arguing that this is the area of law that most directly affects value, and has the most potential to cause carry over liabilities to the buyer for continuing problems. If a broader representation on compliance with laws is agreed to, seller should recognize that its potential liability has been broadly expanded, and that the limitations, such as notification, knowledge, and materiality become more important.

All expenses and taxes paid. If seller remains responsible for pre-effective date operating expenses and taxes, seller may argue that this should not be a subject of a representation as it is covered by that provision, and a second remedy should not be created. If buyer is to assume liability for these, by perhaps assuming (at least at some point in time-as in the example PSA) all liabilities regardless of when they arose, buyer may argue it needs this representation to know where it stands. Seller should then be aware that the representation, so long as it survives, largely negates the assumption by buyer if a breach of representation exists, and thus should be resisted, at least in an absolute statement form.

List of Contracts. This list is a burdensome undertaking, and fraught with possibility for errors, particularly on non-operated properties and/or properties purchased from others. If Seller agrees, it should at least be limited by "materiality" and "knowledge". Another possible list limitation is to exclude contracts customary in the industry for the list. A seller may argue contracts can be discovered through due diligence, and propose as an alternative to representations that a "Defect" being crafted for contracts that adversely affect net revenue interest and/or expense interest stated for "Defect" purposes, or otherwise impose burdens not customary in the industry (a had concept to define).

Condition of equipment and abandonment liabilities. This representation is not appropriate in a "Where Is, As Is" deal, however, the parties could consider making it a "Defect" since this could be discovered through inspection. The defect standard will be had to establish, at least on "condition" (see discussion of Defects below).

Buyer succeeding as operator. This representation is sometimes requested where operatorship is important to buyer. Seller should resist such representations. Operatorship is usually not transferrable (at least under standard operating agreements) so this is usually not a representation that can truthfully be made and thus shouldn't be made. If this really is an important part of the deal, seller should seek to have it handled through the "Defect" process issue or as a closing condition instead.

"Everything I ever told you is true". This broad representation is sometimes requested and should be strenuously resisted. It is a gross transgression of the concept discussed above that generalities in representation that should be avoided. If pressed, seller should ask buyer to identify any particularly important things it feels it was told that are not otherwise covered by other representations, and, if sufficiently limited in scope, a representation (or better, a "Defect" item) could be considered.

Buyer's Representations

The example PSA contains some basic representations by buyer, including one that it is, in essence, a sophisticated purchaser. In some fact situations, others may be appropriate. This presentation will not spend any more time on buyer representations.

Covenants Pending Closing

Usually there is a period of time between signing of the PSA and closing, and there are things that will go on during that period that need to be dealt with. Seller will want as few intrusions as possible into its ongoing operations both generally and/or as to the operation of the properties being sold.

Access for Due Diligence. Sections 6(a)(i) and (ii) of the example PSA deal with buyer's access to records and properties for the purpose of conducting due diligence under Section 7. An acknowledgment that the access is at buyer's risk, and indemnification of seller with respect to such access, is included in Section 6(a)(iii). The provisions are pretty basic, contemplating access at all reasonable times with the copying of records at buyer's expense and buyer having the obligation to return all such copies if the deal does not close. The example text could also be revised so that instead of access "at all reasonable times", access would be during "normal business hours" and, in the case of records, only at a particular location.

The access to records section excludes records seller considers to be confidential or proprietary or those that the furnishing of which may risk legal privilege being lost, may risk violating confidentiality, or other agreements. Buyer may object to the confidential or proprietary category as too broad. Buyer may also request that the nature of any records being withheld for any of the above reasons be disclosed to it. In any case, restrictions on legal privilege documents and documents the disclosure of which is restricted by agreements are important.

The physical inspection section recognizes that buyer's access may not always be possible, particularly with respect to properties operated by others. This section only requires seller to make a good faith effort to obtain access to properties operated by others. Buyer will sometimes require, if this standard of physical access rights is adopted, that it be able to treat as a "Defect" any property that it does not get access to (or gets inadequate access to-although that can get into a problem of defining inadequate access) - the example PSA provides that buyer may assert a defect on a Property if buyer does not get access (this is included to illustrate the point - likely a PSA offered by a seller would not include this language). As written, this section (and Section 7 on Due Diligence) would permit buyer a pretty wide range of environmental testing. If restrictions are desired, more complex language will be needed.

Interim Operations. The example PSA allows seller to continue control of its operations and operational decisions, so long as it does so in the ordinary course of business, doesn't sell any Oil & Gas Properties (i.e. real property assets, leasehold and units), and consults with buyer on operations requiring consent under applicable operating agreements (or where there is no operating agreement, an agreed form). Buyer may well argue this allows seller too much flexibility for assets buyer will soon be owning.

Another version of this section, which is somewhat more restrictive, is attached as an **Interim Operations Rider**. The rider restricts seller from proposing any operations requiring consent under the

applicable operating agreement (or agreed form where there is no operating agreement), or abandoning any wells, thus creating a "stand still" in this regard which preserves status quo pending the contemplated ownership change. This rider also recognizes that seller cannot control what a third party may propose and resolves this situation by postponing a decision on a third party proposal until closing occurs, and if that is not possible, falling back to the example PSA result where seller makes the decision. As a practical matter, unless there is a lot of activity on the properties, with other parties operating (or active non operators proposing operations), and there is a relatively long time from signing to closing, the scheme set out in the rider for dealing with proposed operations should resolve most situations. Still some buyers may not want seller to call the shots even in the limited case where a third party proposes the operation and the decision is due before closing. This can get tricky if the parties disagree because the one not deciding runs the risk of being stuck with the other's decision. Of course buyer would prefer to just call all of the shots instead of seller. One solution could be that if the buyer wants to conduct the operation, and seller doesn't, seller will farmout the affected property to buyer on agreed terms. If the deal closes, buyer ends up with both sides of the farmout. If the deal doesn't close, buyer pays costs and seller at least still has some interest in a property on which it didn't want to expend funds. Theoretically, this farmout option could work in reverse, where seller would elect to agree to proposed operation and buyer would not. This is more problematic and a better solution may be to exclude the property and adjust the purchase price downward by the value allocated to the property for "Defect" purposes. Buyer may also want a broader restriction on operational decisions than just imposing limits with respect to those covered by consent provisions of operating agreements, both on general principles and because there are operations of significance that are not necessarily covered in all operating agreements.

The proposed rider covers other areas as well. The rider language also contains more restrictions on what buyer can do in terms of disposing of property. Plus, there are other possible variations to the rider including imposing dollar limits on transactions. Not discussed in either the rider or the example PSA are delay rentals. The example PSA assumes there is not significant raw acreage included in the properties. If there is significant raw acreage, payment (or non payment) of delay rentals, and perhaps other issues, should be addressed. Both the example PSA and the rider contain language clarifying that seller's responsibility for interim operations is no greater than it would have under a traditional operating agreement.

Handling Consents and Preferential Rights to Purchase. Section 6(c) of the example PSA provides a method for handling preferential rights and consents. Under this section, seller's obligation is limited to using reasonable efforts to identify, from its own records, preferential rights and consents, and to request such holders to consent or grant waivers. Seller does not guarantee (and, based on representation exclusions it does not represent) that all consent and preference rights will be found, or that consents or waivers of preferential rights will be obtained. Failure to obtain such consent or waiver will, however, constitute a Defect as provided in Section 7 of the example PSA.

If this scheme is adopted, then the logical extension of it, at least for seller, is to cause buyer to assume the liability (and indemnify seller) with respect to any consents or preferential rights seller did not identify or resolve (and the example PSA contains such language). All so long as seller met the standard

of using reasonable efforts to identify some without being obligated to go beyond its own records. Many buyers will resist this scheme.

Sometimes seller's obligations under this Section are limited to preferential rights. If so, consents need to remain excluded from any applicable representation and, possibly, language indicating seller has no obligation to buyer regarding consents should be added. Also, sometimes language is added contemplating that the election period allowed for the holder of a preferential right will run past closing, raising the possibility of an unknown resolution at closing. The additional language may provide that the affected property will be withheld at closing, and the price adjusted therefore, but such property will be conveyed to buyer in exchange for the amount withheld, if such waiver is obtained within a certain time. The parties can also handle this situation in the same manner, outside the wording of the PSA, should such a situation present itself and buyer assert it as a "Defect".

Due Diligence/Defect Process.

The purpose of the due diligence/Defect process is to allow the buyer an opportunity to verify assumptions it made in deciding to buy the properties and setting the price. Discrepancies may be dealt with through price adjustment mechanisms, opportunities for seller to cure problems, etc.

The example PSA assumes that the due diligence/Defect process will be the way that buyer assures itself that it is getting what it thinks it is paying for, to the extent that assurance is possible, and verifies its assumptions. As noted above, the example PSA assumes the due diligence/Defect process will be the principal way buyer obtains such assurances - not representations. It must also be said that, to some extent, the due diligence/Defect portion of the example PSA was drafted to demonstrate possible provisions and that many seller proposed PSA's would offer buyer fewer "Defects", and probably offer none of the "Defects" included in the **Additional Defects** riders attached.

Overall Structure. In the example PSA, the diligence process is structured as a single, unified process. Other PSAs may provide a separate due diligence process for environmental and title, with different time frames, separate adjustment procedures, etc. Price adjustments under the example PSA are subject to various thresholds and deductibles to try to eliminate small claims. One advantage to a unified process is that the overall deductible with respect to a price adjustment for Defects is applicable to all Defects. If the process (and, in particular, the price adjustment process) is split into two pieces, a situation can arise where most of the asserted Defects happen to be either title or environmental. The deductible for that Defect type is then exceeded and a price adjustment occurs, while there remains unused deductible for the other Defect type. Another alternative to address this issue is a PSA with separate due diligence tracks, but with a unified price adjustment or price adjustment limitation section. The example PSA provides for the Defect process, including any resulting price adjustments, to be concluded before closing. For seller, it is generally better to conclude the entire process before closing because a certain amount of leverage (psychologically, if no other way) is lost by seller with respect to this process once closing occurs, particularly if the ability to assert Defects carries on past closing too.

The PSA provides for a schedule to be prepared listing all wells and units (note that the example PSA includes undrilled proved undeveloped locations, "PUD locations"), the expense interests and net

revenue interests for each, and an allocated dollar amount for each. The schedule should be prepared with great care. It should be accurate and the line items clearly identifiable. The PUD locations will need particular care-including a land description, and objective formation for each. Seller should ask buyer to provide the initial value allocation to each well, unit and PUD location, but seller should review it carefully. Seller should not hesitate to suggest changes if it feels some values are inappropriate. Depending on how this section of the PSA is ultimately drafted, other information may need to be scheduled as well (for example, see discussions below on situations where a Defect item is established for raw acreage, successor operatorship, etc).

Logistics. The example PSA provides for Defects asserted by buyer ("Asserted Defects") to be presented to seller as soon as they are identified and within an outside cutoff date. The Asserted Defect must also include certain information about the alleged nature of the Asserted Defect, and a proposed price adjustment. Given the expedited nature of many transactions, it is important for seller to get notice of Asserted Defects as they are identified in order for seller to have any realistic chance of curing them. Some PSAs just provide an outside date for submittal and don't provide for Defects to be submitted when identified.

As noted above, the example PSA assumes a pre closing conclusion to the due diligence/Defect process, including arriving at any price adjustments. Some PSAs do provide for some or all of the process to continue post closing, and, when that happens, there are additional issues to deal with. Is the ability to assert Defects extended beyond closing, or only the opportunity to cure? Is the price adjusted downward at closing for properties with unresolved Asserted Defects, or is full purchase price paid subject to potential future refunds? If price is adjusted at closing, is the adjustment the buyer's proposed adjustment amount, the full allocated value for the affected property, or some other amount? Are the Asserted Defect properties retained by seller out of the group conveyed at closing, or is everything conveyed? Can buyer require seller to retain them if they are, say, Asserted environmental Defect properties? If the Asserted Defect properties are conveyed at closing, how does seller go about curative, particularly for environmental matters, and are there indemnities and other assurances? How does seller ensure payment if all properties are conveyed but the purchase price adjustments are withheld by buyer until curative occurs. Likewise, how does Buyer ensure a refund if the purchase price adjustments are not withheld? How do withheld amounts or refunds due get paid-in pieces as items are cured or upon agreement that such item will not be cured, or all at once? What happens if the adjustment amount ultimately, and after closing, ends up being in excess of the amount at which that seller or buyer can terminate the transaction (such as in the closing conditions in Sections 9(c) and 10(c) of the example PSA)? Will there be an "unwind" of the deal, complete with reconveyances (presumably with special warranty of title), return of amounts paid, and accounting for revenues received and expenses paid while buyer held the properties? If no unwind is allowed, does seller lose a significant right and counterbalance to an overzealous "Defect" assertion? The Rider titled **Post Closing Curative** (further discussed below) gives seller the right to continue curative work on Asserted Defects post-closing. The rider also provides language that gives a little flavor of how the issues in this paragraph can be dealt with.

Nature of Defects. As discussed generally above, the example PSA provides for broad due diligence rights, hence there are a fairly large number of items constituting Defects. The more Defect items, obviously, the more possibilities exist for defects to be asserted and price reductions to occur, so, theoretically, it would be better for seller for there to be fewer Defect items. Buyer, on the other hand, will want Defect items covering matters that might affect its valuation of the properties. The trick is to find an agreeable set of Defect items that will

accommodate the buyer's wishes to the extent possible (and reduce the representations made by Seller) and yet not overdo it.

Whatever Defect items are agreed to, they should be as detailed as possible, such that there is a fairly clear line as to whether a Defect exists or not. Sometimes Defect items are written very open-entitle. This can create a free for all where buyer can assert almost anything as a Defect, and seller can reply that almost anything buyer asserts fails to qualify as a Defect. This is not a desirable situation, potentially creating confusion and acrimony, and, arguably, turning the PSA into what is really an option (that buyer paid nothing for, and therefore may be unenforceable).

Despite efforts to abide by this drafting principle, some of the Defect items included in the Additional Defects rider, and the **Alternative Environmental Defect** rider, are troubling in light of this principle. Examples include the reference in the Alternative Environmental Defect rider to "likely to result in liability to third parties" or the references in the Additional Defect riders to "not customary in the oil and gas industry and materially adversely affect" regarding contracts in force and to"adequate repair and condition..." regarding condition of equipment. Who judges "likely", "customary", "materially adversely affect", "adequate" and other such standards? Still, in come cases, some lack of a bright line may be unavoidable. In Section 7(b)(iv), the question of who judges "would normally be waived" is better than the alternative which is to concoct a list of what counts as a Defect and what doesn't and still probably be left with something general as a catch-all at the end.

A few notes on specific Defect items in the example PSA:

Section 7(b)(i), NAI and WI variances. Note that a Defect is limited to currently producing completions in wells and unitized formations in units (and projected objective formations in PUD locations-more on PUD locations later) and this limitation is carried over to other Defect items, both those in the example PSA and in the Riders. This is probably all buyer gave value to, so there should not be price adjustments for variances that affect other depths. If buyer did value other things, such as behind pipe zones in existing wells, or even raw acreage, modifications can be made to the language. Attached are a couple of possible **Raw Acreage Defect** riders. Behind pipe zones could be handled similar to PUDs by identifying the wells and zones. PUDs have been included in the example PSA to demonstrate that when value is given to non producing assets, that those assets may need to be dealt with in the Defect process. If there is no value given to PUDs, references to PUDs would be omitted from the example PSA. Note that including PUDs requires some extra effort in preparing the schedule used for reference in the Defect process as lands included in each PUD will need to be identified, as will objective

depth (see example Schedule I attached to example PSA). Payout status, and payout balance, can affect value, but, generally, if such situations affect relatively little value, language on these situations may not be not included in the PSA, although the schedule showing NAI and WI may provide APO and BPO figures, and may even show a payout balance as of a certain date, or the basis of payout. The last sentence of this section in the PSA has been included to deal with such situations and assumes Schedule I will include assumed parameters on each situation.

Section 7(b)(iii), Pref Rights and Consents. This works with Section 6(c) to allow buyer to claim a Defect for Pref Right waivers and consents that were not obtained. Some sellers will not include this as a Defect, and still limit their obligations regarding identifying and requesting, as set forth in Section 6(c). Such sellers believe, if those efforts are unsuccessful, buyer can either take the property or not, but without adjustment. This is more true with respect to consents as there is probably a feeling that, given a substantial buyer, and assuming a standard of reasonableness applied to granting consents, consent can't really be withheld, so failure to obtain a consent shouldn't, as a practical matter, affect assignability or value. If an agreement is silent as to whether reasonableness of consent is required, some states may impose that the party granting consent act reasonably and in good faith. These states include Idaho22, Oregon23, and Utah24. However, Louisiana takes a more literal approach on the issue of consent. If the parties to the agreement do not draft for the consent to be reasonable, the courts will not impose such a duty but will require that there not be an abuse of the right to not grant a consent. The Louisiana Supreme Court explained in *Truschinger v. Pak*25, that it will apply the abuse of rights doctrine if (i) the predominate motive for not granting consent was to cause harm; (ii) there was no serious or legitimate motive for refusing such consent; (iii) the exercise of the right to refuse is against moral rules, good faith or elementary fairness; or (iv) if the right to refuse is exercised for a purpose other than that for which it is granted. An economic reason for not granting consent will not qualify as an abuse of rights.

If the parties specifically address that consent rights cannot be unreasonably withheld, the courts will generally upheld such requirement. In Texas, the withholding of consent for economic reasons is considered reasonable.26 The standard is also found in several other states. The Texas Court of Appeals held that unreasonably withholding consent is an action for damages based on breach of a promise27

Section 7(b)(iv), Imperfections in Title. Usually the provisions for imperfections in title do not draw as bright of a line as might be preferred. Some PSAs list what is and is not an imperfection constituting a Defect. There is some merit to this as it does at least clarify the listed situations but it does add verbiage and may well end up with a generalized catch all at the end anyway. This Defect item refers back to the NAI and WI variances Defect item in Section 7(b)(i), and it imports the standards and limitations (as to formations and completions) contained therein.

Section 7(b)(v), Environmental. This narrower version creates brighter lines as compared to the Alternative Environmental Defect rider. Such comparison gives some idea of possible variations but not all possible variations. This item is not limited to existing producing completions,

formations, and PUD objectives as environmental problems generally affecting the property can be an issue whether or not they relate to specific zones. The last sentence addresses that a buyer might want to Defect or reject a property it could not inspect for environmental issues. The addition of this sentence is made to illustrate the point, it is not necessarily what a seller would volunteer in a draft.

Following are a few notes on specific Defect items included as **Additional Defect** riders:

Raw Acreage Defect riders. Most producing property sales do not give much, if any, value to raw acreage. Where there is substantial value attributable to raw acreage, a Defect item may need to be created. NAI and WI figures can be created for raw leasehold tracts (much like PUDs are handled in the example PSA), but more often raw acreage is valued on a per net acre basis. These two examples assume a net acre valuation method. The first example assumes net acres will be computed on a lease by lease basis (or, in a few cases, lease grouping basis) and shown on the equivalent schedule to Schedule I in the example PSA. The second example assumes the same will be done, but on an area by area basis (each area will need to be described on Schedule I, similar to PUD locations, but presumably covering a bigger area, including a number of leases). This second version is theoretically better for seller as it allows for the possibility that a shortfall on one lease may be made up with an overage on another. A few notes:

(1) the rider provides that net acres are computed only for a certain formation-this is consistent with the concept in 7(b)(i) of the example PSA that only certain zones are really given value by the buyer, as is often also true with raw acreage (the rider assumes the same zone for all leases or areas, if that is not true revisions may be needed, if buyer states that all depths have value, an issue will exist as to how to handle depth limited leases),

(2) using this language, amount of acres covered by a lease does come into play, even if a lease covers the exact same mineral interest as was assumed (with the same undivided interest being owned by seller as was assumed) there will be a Defect (under a dollars per net acre scheme) if the leased tract is smaller than assumed, and

(3) these riders do not take into account variations in royalty and override burdens (and thereby NAI)-buyer might choose to add that a lease with more than a certain royalty burden could give rise to a "Defect" determination of some kind.

Gas Balancing, Prepayments rider. These issues do not seem to be as prevalent as they once were, so this presentation will not spend much time on "Defects" for these issues. Obviously though, incorrect imbalance assumptions will affect valuation. In simplest terms, if buyer assumed no imbalances, and an overproduced situation in fact existed, the affected property would be worth less. The example Rider is prepared to show a wide range of issues. It assumes, for example, that there were properties on which both overproduced and

underproduced positions were assumed by buyer to exist, and that those assumed positions were considered in valuation by the buyer-if this were not the case, the second and third sentences could be eliminated. It also assumes that buyer will be concerned about how royalty accounting on imbalance production may have affected its obligations and thereby valuations. If that is not the case, the last sentence could be eliminated.

Successor Operator Defect rider. In some deals, the ability to become successor operator is important to buyer. As noted previously in the discussion of representations, seller probably cannot represent that this will happen, given the successor operator provisions of most operating agreements. Thus it is suggested that establishing a Defect item might be one way of dealing with the issue. This Defect item should only be added if this is an important issue for buyer, and then only for the particular properties where it is important. A Successor Operator Defect rider is attached. While the example PSA assumes the Defect process will be concluded by closing, this particular Defect item may be difficult to conclude in that time frame.

Seller Response to Asserted Defects. The example PSA offers several possible responses by seller to an Asserted Defect.

The indemnification option is the most unusual. A buyer may not agree to indemnification feeling that it is not a satisfactory solution to many Defects particularly when liability is capped at the allocated value of affected property, as in the example PSA. Buyer may also be concerned with its ability to rely on a continuing obligation by seller-that depends on the seller. The indemnification option is usually not a particularly good option for seller either. It probably isn't a particularly satisfactory solution to many Defects, and it imposes a continuing, and somewhat open ended obligation (unless capped at allocated value as discussed above). Nevertheless, many sellers will want to include this as an option because using it is at seller's option, and seller doesn't have to choose it.

There is also an option to defer closing to allow more time for curative. This is usually a better option than continuing the process post closing even if limited to curative effort. The **Post Closing Curative** rider contains additional language that could be added to Section 7(c)(i) if the parties agreed post closing curative efforts could be allowed.

Some PSAs have elaborate provisions on remediation of environmental Defects as a response by seller. These provisions provide how it will be conducted, rights to conduct it if it continues past closing, how costs will be determined and possibly shared, etc. The example PSA assumes that a remediation response falls within the option for seller to cure, that the work will be conducted pre-closing (while seller is still the owner) and that seller will work with buyer as part of the response process to assure that the proposed "cure" will resolve the problem.

A Defect Must be Handled as a Defect. In the example PSA, Section 7(d) provides that an Asserted Defect (and a Defect identified by buyer, but not asserted) will not be the subject of any other remedies buyer may have under the PSA including, specifically, representations or indemnities. This is consistent with Seller's theory (discussed above) that buyer's primary avenue for assuring itself that it is

getting what it thought it was buying is the due diligence/Defect process. It is also consistent with the idea that there should not be multiple remedies for the same issue. Buyer may say that, even if it accepts this general proposition, it is getting no remedy for discovered but unasserted Defects. The seller's response will be that it is the buyer's choice not to assert the Defect. The remedy is available but buyer elected not to pursue it. As a practical matter, it may prove difficult to prove that buyer found, but failed to assert, a Defect. However, if this concept is not included, it allows buyer to potentially choose a different remedy for an item. For example, if the PSA provides that seller remains responsible for pre Effective Date environmental issues, even with a limit on the survival of that obligation, buyer could choose to be indemnified with respect to a problem it found in due diligence. Why? Buyer may prefer that remedy over asserting the issue as an Asserted Defect because getting a one time price adjustment may prove inadequate in retrospect and also each defect increases the risk that the total amount of Defect adjustments will exceed the price adjustment limitation in Seller's conditions to close as stated in Section 10(c) at which point seller may terminate the deal.

As noted above, the example PSA provides for this treatment for not only Asserted Defects, but also Defects identified by Buyer but not asserted. Seller could draft this language so that the due diligence/Defect process is the only remedy for any Defect, whether identified by Buyer or not. There is a sentence in Section 7(a) of the example PSA which says that all Defects not asserted are waived for all purposes, excluding, in the example PSA, undiscovered title Defects to which the special warranty of title in section 4(a)(v) might be applicable. This language in Section 7(a) arguably gets to the same point as the concept discussed in this paragraph.

Ideally, representations would be limitedly written to matters not covered by the due diligence/Defect process, and Seller's retention of liability/indemnification would also be written so as not to overlap the due diligence/Defect process, but section 7(d) will help prevent any unintended overlap in remedies.

Price Adjustment Procedures.

Price adjustments apply to Asserted Defects that are not cured (or deemed cured, for example if the indemnification option is included and elected by seller). Either buyer and seller agree on a price adjustment or, the affected property is retained by seller and the purchase price is reduced by the full allocated value therefor (on Schedule I in the example PSA). This leaves seller with the recourse of keeping the property if the parties can't agree-providing some check on the buyer's valuation of Asserted Defects. But this is not always a completely satisfactory solution for seller. If, for example, seller is selling everything or is wanting out of an area, being left with a few isolated properties is not preferable. The buyer probably knows this, possibly affecting how buyer proceeds with this process. This is somewhat mitigated by the clearing house market's growing popularity and increasing ease of use for sellers of small properties. The price adjustment limitations in Seller's closing conditions (Section 10(c)) gives seller another check on buyer's activities by providing that if the total price adjustments get high enough, the seller may call off the transaction.

Some PSAs contain an arbitration procedure where disputes over the existence of a Defect, and/or over the appropriate amount of the price adjustment for a Defect, is referred to a third party or parties for determination. This is another possibility, although the example PSA does not contemplate its use. Buyer may want to add the ability to exclude a property affected by an environmental Defect or a property it was not able to inspect and receive an adjustment for the property's full value allocated for Defect purposes. This is particularly the case if the adjustment procedure provides (as the example PSA does) that adjustments for a property may not exceed the value allocated to it for the Defect process, as seller might let buyer take the property with a full value price adjustment in a case where seller could be escaping a liability greater than the value. If seller agrees to allow a property to be rejected in such a situation, it might wish to provide that, if the situation involves an environmental Defect the value of which is less than the value allocated to the affected property for defect purposes, seller will keep the property, but only suffer a price reduction equal to the (lesser) Defect value. This keeps buyer from just rejecting properties with environmental issues.

Agreed Mechanical Valuations for Defects. For a couple of types of Defects, the example PSA provides for a mechanical valuation method that seller may elect to apply and, if applied, buyer must accept. The Riders also provide similar valuation methods for a couple of other Defects that are not included in the example PSA. As the example PSA is written, use of the mechanical adjustment for a Defect is at seller's option. Buyer may want to have this option too, but if buyer is given that option, then at least with respect to Section 8(b)(i), it should only apply to clear reductions in NAI such as clause (A) of Section 7(b)(i) and not to other matters that might affect a portion of seller's NAI in some way. Why? Those "other" things likely have a "qualitative" aspect to them (see discussion below) and are not necessarily properly valued at the full mechanically computed proportionate reduction contemplated in Section 8(b)(i). If seller wants to accept the full reduction, and ignore any discount for qualitative aspects, that is one thing, but buyer should not be able to impose it. The Rider dealing with valuing gas balancing defects assumes that the parties will agree on a price per unit for any unanticipated imbalance and that a mechanical valuation will be the agreed price multiplied by the defect volume. A couple of notes: (1) if this is agreed to, arguably the price should be less than the current gas price as the imbalance will be recouped over time and the value should be discounted for the time value of money, and (2) while agreeing on a price is a convenient way to handle this (and maybe good enough for the parties), all gas imbalances are not equal--an unanticipated overproduced position on a long life, low production volume property with a 20% make up right should reduce the present value of the flow of funds to buyer less than the same size overproduced position on a high production volume property with a 33% make up right. A lower make up right should theoretically have a lower price per unit price adjustment, and if not specifically addressed, agreeing on a mechanical adjustment may not be a good idea.

It might be desirable to have even more mechanical valuation situations, but they are not easy to construct for other Defects. For example, for title Defects such as those in Section 7(b)(iv) that do not necessarily result in a reduction in interest and arise perhaps from old flaws that may or may not be asserted or valid, there is what could be called a "qualitative" or "risk weighting" aspect. Some consideration should be given to the fact that buyer may well never be affected by the flaw. That makes mechanical valuation probably not appropriate, although, as noted above, if seller wishes to ignore the

"qualitative" aspect and take the full mechanical reduction, that might be OK as buyer should not expect any greater adjustment. However, buyer should not have the right to insist on a mechanical adjustment ignoring the "qualitative" aspect. The cost of dealing with an environmental Defect may be subject to some debate, and it may depend on the size of the company and its overhead costs. Some suggest that expense interests can be treated the same as revenue interests, in mechanical adjustments, but expense interest variances do not bear a particularly direct relationship to value as is the case with revenue interests. Even revenue interest variations do not bear a strictly direct relationship to value. A revenue interest reduction not accompanied by a proportionate expense interest reduction would probably, if the property was reevaluated using the changed figures, result in a greater reduction in value than the proportionate reduction contemplated in Section 8(b)(i), if for no other reason than that the point in time when expenses exceed revenues-economic limit-would be reached sooner.

Upward Adjustments. Seller will want to be able to benefit from any increases in interest that may be discovered, and Section 8(c) of the example PSA contemplates this increase, which sometimes occurs. Buyers sometimes ask that increases only be used to offset decreases resulting from Defects, and that the total purchase price cannot be increased beyond what was agreed to (the example PSA does not do this). The provided Rider carries this concept over to raw acreage situations, and gas balancing situations.

Limitations on Adjustments. The example PSA provides for several levels of limitations on adjustments. Seller's logic for these limitations is that it (a) does not wish to be "nitpicked" over each and every small item, (b) engineering evaluations, which buyer probably used as a tool in determining what price to pay, of properties are not a completely precise matter, and (c) it makes little sense to waste both parties' time on small matters. Of course, as purely a matter of self interest, anything that reduces the potential for price reductions is a benefit to seller.

The example PSA imposes two limitation levels. First, the price adjustment for an Asserted Defect must reach a certain level or the Asserted Defect will be ignored as de minimus (referred to herein as De minimus Asserted Defects). Second, all Asserted Defects that are not eliminated by the first limitations are considered, their related price adjustments are added up, and, if the total does not exceed a certain level, no price adjustments are made (referred to herein as Defect Minimum). If the Defect Minimum is exceeded, the adjustment is only the amount such total exceeds the Defect Minimum. Overall, the PSA also provides the total price adjustment related to a property cannot exceed the value of the property, which is a consideration at least for environmental issues.

As written in the example PSA the De minimus Asserted Defects limitation is in the nature of a "threshold", that is to say that once the applicable level is exceeded, so the Asserted Defect is not excluded, the full adjustment related to such Defect is included in the adjustment process. This is still also subject to the effect of the Defect Minimum limitation, of course. As an example: if the level an Asserted Defect must reach is $5000, and if the adjustment related to an Asserted Defect value is $4999, the Asserted Defect is excluded, but if the related adjustment is $5001, the Asserted Defect is included at $5001. As written in the example PSA, the Defect Minimum limitation is in the nature of a "deductible". As an example: if the amount used as a Defect Minimum limitation is $500,000 and the

total price adjustments attributable to Asserted Defects not excluded as De minimus Asserted Defects is $525,000, the adjustment will be $25,000. The De minimus Asserted Defect limitation could be written as a "deductible" and/or the Defect Minimum as a "threshold." In negotiating limitations, it is important to remember the difference between a "threshold" and a "deductible." It is overlooked by negotiators on occasion.

In some seller PSAs a third level of limitation is added--the aggregate price adjustments for all non-De minimus Asserted Defects with respect to a property must reach another level, or all Defects related to that property will be ignored (referred to herein as Per Property Minimum). This has the practical effect of excluding from the Defect process all properties assigned a lesser value than the Per Property Minimum. This limitation may be written as a "deductible" or a "threshold".

There are many ways to write a limitation on adjustments scheme. Buyer would prefer no limitation. Seller would prefer that De minimus Asserted Defects (and, if included, Per Property Minimum) limitations were deductibles rather than thresholds. Buyer will resist having all solely deductibles, especially if there is a Defect Minimum, claiming he feels he is being "deductibled to death". The Defect Minimum can be a threshold instead of a deductible, and buyer would prefer that. If Seller proposes a Per Property Minimum limitation, Buyer may also argue that it is duplicative to some degree of the De minimus Asserted Defect limitation, and that seller may have one but not the other. Buyer may make the same argument to try to limit the limitation scheme to just one level (probably a Defect Minimum).

Conditions to Closing

The purpose of closing conditions for both seller and buyer is to recognize that there are some circumstances under which a party may elect not to close the transaction. These are conditions which must be met or else a party may elect not to close. The example PSA sets forth four such conditions, the same four for each party. A seller probably prefers as few conditions as possible.

In some situations, a condition is not met due to matters affecting only one or some portion of the properties such as a breach of an environmental representation. To address this, a provision has been added to buyer's closing conditions that allows Seller to elect to have the matter treated as a Defect. This eliminates buyer citing the matter as a failure of a closing condition, but still provides buyer a remedy (albeit a different remedy). Seller would suggest that, in such a situation, it is not an appropriate remedy to allow buyer to elect not to close because the price adjustment procedure through the Defect process is a more appropriate-and less draconian-remedy. Buyer may argue that in the case of the breach of representation example, the example PSA is written such that the breach must be "material", and this is a sufficient limitation on buyer's right to cite the condition as a reason not to close.

One of the closing conditions for each party is that the Defect purchase price adjustments not exceed a certain dollar amount. Buyer's condition includes both upward and downward adjustments while seller's condition only includes downward adjustments, for obvious reasons. For seller, this

provides an additional control on the Defect process-if buyer seeks too many adjustments, it may lose the deal-and seller may also feel that, at some point, the deal has changed enough that it no longer makes sense to him. Seller would prefer that buyer's closing conditions not include this provision, at least for downward adjustments, however, many buyers feel the condition should be parallel (just for the sake of being parallel) and just like for seller, at some point, the deal is not what buyer thought it was getting. If buyer is concerned about what it is getting, adjustments for preferential rights under section 6(c) should also be included in the calculation for buyer's condition-as it is in the example PSA--since properties can drop out of the deal that way too. There is no need to include this concept in seller's corresponding condition to closing because seller shouldn't care about these Section 6(c) adjustments since it gets the money either from buyer or a preferential right holder.

Some PSAs contain additional closing conditions beyond those in the example PSA. Many are deal specific, and beyond this presentation. One seen with some frequency involves "material adverse change" to the properties. It is submitted that where the sale is of a group of properties (as opposed to, say, a single office building) it is unlikely that there would be a change that affected the properties as a whole other than, perhaps, a precipitous product price drop, or other generalized event. Seller would certainly declare these as a risk buyer takes, not something that should form the basis of a “walk away” right. To the extent that a material adverse change results from a casualty loss, the example PSA handles that under Section 15, with a price adjustment through the Defect process being a possibility. This is a more appropriate remedy when (as is very likely) only one or a few properties out of the group of properties in the deal are affected (unlike an office building sale where the casualty affects all the property in the deal-since there is only one property). If for some reason the casualty loss is more widespread (for example the properties are all in southwest Louisiana and the adjacent part of the Gulf of Mexico and Hurricane Rita damaged them all) the dollar amount of adjustments using this process will be high enough to trigger a failure of a closing due to the price adjustment limitations condition. Attached for informational purposes is a **Material Adverse Change Condition** rider. Remember, a seller believes this rider is unnecessary and will resist its use.

The conditions to closing sections also provide for what happens if a condition is not met, and a party wishes to elect to not close. This language addresses what happens to the Deposit but such language could easily go in the Deposit section instead.

Closing-the Closing Itself

The parties need to agree on when and where the closing occurs, and on what is to transpire at the closing (delivery of documents, payment of money, etc.). This seems rather obvious, but a section providing a bit of a roadmap is valuable. The example PSA assumes a very straightforward closing. In any given transaction there may be more going on than what the example PSA provides for, due to the nature of the transaction and/or the properties and parties involved. There may be, for example, a transition services agreement to be signed, there may be licensed data to be dealt with, etc.

In the example PSA, the Effective Date is defined in the Closing section-there are obviously a number of other places where this could be done. Also, the conveyance form is first referred to in the Closing section. It is suggested that, if possible, a conveyance form be agreed to in the PSA to avoid

dispute over this document at the time of closing. In fact, it is suggested that this occur if feasible with respect to all significant documents to be signed at closing that have some likelihood of disagreement over wording. The language regarding the conveyance in the example PSA also provides that Exhibit A to the PSA will be used as Exhibit A to the conveyance (with any agreed changes), which should logically be the case. The agreed changes may be some needed corrections discovered through due diligence and any properties excluded through the due diligence/Defect process. The example PSA also refers to attaching Schedule I to the conveyance but this would not occur in the absence of a title warranty provision, since it is not needed for the conveyance, just adds extra pages, and discloses information not necessarily the business of others.

In the payment to seller section, take note of the way the example PSA defines Purchase Price (see Section 2). It includes all adjustments for Asserted Defects, and exercised preferential rights, discussed in Section 6(c), so it is not necessary to further provide in this section for adjustments for those matters (its not an oversight, even though it may look like one!). The payment to seller provisions assume that the accounting adjustments in Section 12 will be available for closing-preferably a day or so before. That way, the amount of funds to be wired can be easily determined in advance. Included is an Interest on Purchase Price rider-some sellers will argue that, since buyer is getting the benefit of the properties from before the closing (back to the Effective Date), seller should get the benefit of use of the purchase price funds (in the form of interest on the funds) as well.

Closing-Post Closing/Transition Activities

There will be matters which require transition efforts between buyer and seller. Some transactions have an entire agreement devoted to this subject-often called "Transition Services Agreement" or "Transition Agreement". These agreements are beyond the scope of this presentation. The example PSA assumes that, in many cases, the transition issues are not complex and can be handled without a separate agreement, and it attempts to handle them in Section 11(b). Obviously this will not be the case in all transactions. As a part of this assumption, the example PSA assumes that buyer will want to, and be able to, take over operations of any seller operated properties at, or soon after, closing. If this is not the case, at least Section 11(b)(ii) will need modification, and a separate agreement may be suggested.

Files. Some PSAs include files in the definitions of properties being purchased, and that can be done. The example PSA assumes that Section 11(b)(i) accomplishes the transfer over of the files, and does it in connection with handling other file related issues. The example PSA gives a pretty generic list of files being transferred. Both parties may wish to refine this more.

This section again raises the issue of files the furnishing of which may risk legal privilege being lost or risk violating confidentiality or other agreements, as well as records seller considers to be confidential or proprietary. This matter was discussed previously under "Covenants Pending Closing" and "Access for Due Diligence" and won't be discussed again here. The issues are the same.

The example PSA makes it clear that geological and geophysical data is not being turned over with the files. The problems that may be encountered in transferring such data (and other issues related to such data) were discussed previously when discussing the properties being sold, and won't be discussed again here.

The example PSA allows seller to keep copies of files, which seller really needs the right to do. It also provides that buyer will retain the files turned over, and give seller access to them for a period of time. Buyer may resist this obligation, unless the time period is brief, probably briefer than what seller wants. Buyer may want to specify that it has no obligation beyond its regular record retention procedures, and may want off the hook if it sells the properties (maybe after it notifies seller in advance of the sale so seller can make copies, etc).

Operations. As noted above, the example PSA assumes that buyer will be ready, willing and able to take over operations as soon as possible after closing. If it is contemplated that seller will operate for buyer for a more substantial period of time, this section will need modification to reflect that. If there are specific matters buyer requires assistance with other than normal operations under an operating agreement, and revenue disbursements, the parties may wish to add those.

Disbursements. The example PSA assumes seller will continue any production revenue disbursements it is doing on the properties at least through the accounting cycle in which closing occurs (accounting cycle is assumed to be a calendar month but may not be). It also assumes that disbursement responsibilities will be divided between the parties based on when funds are received (not on what periods the funds relate to). Obviously there are other ways to handle this transition, but it does need to be dealt with in a manner where responsibilities are defined. The example PSA assumes that seller retains all suspense funds-this is not always the deal, and if buyer is to take over those funds, it needs to have them paid over to it to assume responsibility for them (although how much can be a matter of some negotiation).

Accounting Adjustments.

A basic principle of oil and gas property sales is that the properties change hands, at least in terms of revenues and expenses, as of an Effective Date. The purpose of this section is to effectuate that principle and recognizes particularly that, if the Effective Date is of much time before the closing, it is likely seller will receive revenues and pay bills attributable to periods after the Effective Date. Under the PSA, these are really the revenues and responsibilities of buyer once closing occurs. It is also possible the reverse will occur to probably some lesser degree. The example PSA assumes two steps in this process: (1) an adjustment at closing based on data known at that time; and (2) an adjustment sometime later. The second adjustment is presumably after payments and billings will be with buyer and the amounts needing adjustment will be substantially, if not completely, known.

Sometimes there are matters for which a strict "before Effective Date/after Effective Date" convention is not followed, and, if this is the case, it needs to be dealt with. For example, if a well was drilling at the Effective Date (or completed not long before the Effective Date), the entire cost of the well

may be charged to buyer as it will be the beneficiary of the expenditures. This can be true with other expenditure items-construction of facilities, a seismic program, etc. In the example PSA, a way to deal with this would be to add another item to the list of things following the phrase "in making such adjustments" that is similar to the **Carry Over Costs** rider which is attached.

A few comments on specific provisions in the example PSA:

The example PSA provides that seller will receive overhead charges (both from third party non operators and on its own interest after the Effective Date, and a charge is agreed to for properties without an operating agreement (presumably mostly 100% owned properties).

A provision is made for situations (in some western states, for example) where ad valorem taxes for one year are assessed based on production from the previous year. These are treated as taxes for the year assessed, not taxes for the year of such production. Absent such a provision, some buyers will contend they are not responsible for ad valorem taxes assessed on this basis for the year in which the Effective Date falls, because they are assessed based on the prior year production.

Income tax obligations are expressly excluded. While this seems obvious, it sometimes becomes an issue. In addition, many parties do not realize that, where the Effective Date precedes closing (as is almost always the case), revenues and expenses between Effective Date and closing are seller's income and expenses for income tax purposes, regardless of what the PSA provides. This is because the date on which ownership changes (and who has income and expenses for tax purposes shifts), in the eyes of the Internal Revenue Service, depends on when the benefits and burdens of ownership shift from seller to buyer. Usually, such shift occurs at the closing date because that is when cash is paid, possession is delivered to buyer, and the risk of loss on the property shifts to buyer. Usually there are contingencies on the closing up until that date so seller would retain the benefits and burdens of ownership until then - and since seller is the owner, the income and expenses are reported on the seller's tax return. If the income exceeds the expenses during period between the effective date and closing, the IRS sees the amount paid by the buyer at closing as less (since it got the interim income and expenses for tax purposes) and therefore the purchase price (as determined for tax purposes) is decreased (and the amount of capital gains income seller receives is decreased). The opposite is true if expenses exceed income during that period. A discussion of tax issues is beyond the scope of this presentation, but suffice it to say that some sellers believe that if they have to pay tax on money that ends up going to buyer, the tax should be paid by buyer. If this was being written completely from a seller perspective, the example PSA should arguably require buyer to reimburse Seller for such taxes. If there is a long period of time from the Effective Date to closing which makes taxes significant, maybe the PSA should provide for reimbursement but that opens up a lot of issues to negotiate. The deal normally is that taxes are not considered, which the example PSA clarifies.

If there is substantial raw acreage (example PSA assumes there is not), the parties may want to include a clause on how delay rentals are handled (for example, prorated over the period they relate to, much like ad valorem taxes).

The example PSA provides that an initial adjustment is to be made at closing, based on amounts actually paid and received by seller up to that time. The PSA could also allow invoiced expenses which seller has not yet paid to be included in the initial adjustment. This would be more favorable to seller as it would reduce the size of the adjustment, and, in effect, collect funds from buyer to pay those invoices. The example PSA also provides that, in the event of a dispute, this initial adjustment will be made using seller's figures (this does not apply to later adjustments).

No provision in the example PSA is made to resolve disputes in the accounting process (other than providing that seller's figures will be used for the adjustment at closing, but not later adjustments). Some PSAs contain an arbitration type process where the disputes over accounting adjustments are referred to a third party or parties for determination.

Where gas balancing is an issue, some PSAs will provide for cash settlement of imbalances not anticipated by the parties (rather than making them a Defect as in the example PSA). In some PSAs the procedure is used even if it is known that there are imbalances (presumably where they are not considered in the evaluation by Buyer in determining the purchase price). This process can be used, and usually involves a netting out of unanticipated overproduced positions against unanticipated underproduced positions, and using some agreed per unit amount to value the net result (and perhaps stating in the section identifying Defect items that gas imbalances are not Defects and will be treated as an accounting adjustment). The same cautions discussed earlier in connection with valuing a gas balancing Defect apply here as well-since positions are netted as part of determining the adjustment, the process assumes all imbalances are equal and, as previously discussed, they are not. It is suggested that if there is any thought that gas imbalances may be more than insubstantial amounts, the parties may not want to use this procedure, because of the cautions noted above.

Assumptions and Indemnifications

The purpose of this section is to allocate responsibility for liabilities related to the properties being sold, after the deal closes. Historically, this generally was resolved by the seller remaining responsible for liabilities arising before the Effective Date and the buyer assuming responsibility for liabilities arising after the Effective Date. But a number of years ago, that changed, and now this area of the PSA is often intensely negotiated.

Arguably, this came about with the rise in concern about environmental matters, and the fact that many environmental matters (particularly those arising out of the condition of the properties) don't necessarily easily fit into a "before" and "after" division. The reason is that they develop over time and thus can be attributable, to some degree, to both sides of a "before" and "after" divide. The liabilities

more traditionally thought of operating expenses (whether on a joint interest billing from an operator, or direct from vendors), royalties, ad valorem taxes, etc-did more readily fit a “before” and “after” divide. Also to some degree, sellers just became more aggressive about not wanting to be left with many (or, in some cases, any) ongoing liabilities with respect to properties they no longer owned.

However it came about, sellers have begun to negotiate for buyer to assume at least some of the “before” liabilities that, in a “before” and “after” division, seller would have remained responsible for. And in these negotiations, there is a lot of opportunity for variation in how these provisions end up being written.

The example PSA provides that, at Closing, buyer will assume all obligations arising after the Effective Date, plus all environmental liabilities arising out of the condition of the properties on the Effective Date regardless of the fact that the events giving rise to those conditions occurred before the Effective Date. Then, after a period of time, buyer will assume all liabilities related to the properties, regardless of when they arose, except for those identified by buyer (with written notice to seller) before that period runs out.

There are two separate points here. As to the first point of buyer assuming those environmental liabilities, seller will argue that environmental matters relating to property condition develop over time and that, rather than fight between themselves over whether a problem arose out of “before” or “after” occurrences, the owner of the property should be responsible (arguably, this is not unlike how, and why, risk is allocated between parties in a service agreement). Otherwise, if it is not addressed, both parties may end up liable with no clear division as to how much of the problem each is responsible for and possible overlap in liability that may benefit only the claimant. Seller will also argue that buyer had significant due diligence rights and should have discovered any significant environmental issues and dealt with them through the due diligence/Defect process (including getting, or having the opportunity to get, a price reduction), and anything that went undiscovered through due diligence was either missed by buyer (which should be its problem) or is probably an obscure situation in which case, if someone is to bear the “risk of the unknown”, it should be the owner of the property.

As to the second point on the rest of the liabilities, excluding those identified by buyer, being assumed by buyer later, seller will argue that, by the time this assumption comes about most things like expense billings, royalty obligations, etc should have surfaced and been handled by seller who retained responsibility during that time period (or noticed by buyer as specific items seller is to continue to have responsibility for) and seller should not have to be forever looking over its shoulder for contingent liabilities. Further, by the time assumption occurs many may be barred by limitations, depending on the time period agreed to between the parties.

As noted, although generally providing for a shift to seller’s liabilities to buyer, the example PSA does provide that seller will keep liability for items buyer specifically identified (by written notice) before the point in time responsibility shifts-seller will argue this allows buyer the opportunity to protect itself against matters that have been identified as problems, while relieving seller of only unknown issues, or issues buyer has chosen to accept by not giving notice of them.

Also attached are three **Alternate Assumption and Indemnification Provisions** riders. These are just a few of the many ways this section might be negotiated. The first of these riders has buyer assuming all liabilities, beginning at closing. This is an aggressive seller's position, but many press hard for it-some being (1) non-industry sellers to whom absence of carry over liabilities may be a bigger concern, (2) sellers of non operated properties who feel they had little control, and/or (3) just aggressive sellers. The second rider represents the historical "my watch, your watch" approach-buyer assumes post Effective Date liabilities, and seller retains pre-Effective Date liabilities. The third rider proposes a division that has buyer taking all liabilities arising post effective date, plus all environmental liabilities arising out of the condition of the properties on Effective Date regardless of the fact that the events giving rise to those conditions occurred before the Effective Date, and seller retaining all liabilities arising before the Effective Date, other than those environmental liabilities taken on by buyer. Unlike the example PSA, the buyer does not later pick up additional liabilities. The arguments for this approach by seller are the same as discussed above in connection with the example PSA (in the discussion of the "first point"). This is a better result for buyer than the example PSA since buyer does not have to take on any other pre Effective Date liabilities. A variation mixing concepts from the second and third rider and the example PSA, would be to do a straight "before" and "after" split (like the second rider) but then have buyer take on the environmental liabilities assumed in the third rider, but on a deferred basis, in the same manner as it takes on other pre Effective Date liabilities in the example PSA. Yet another variation would be to do the same "before" and "after" division at closing, but have the buyer later take on <u>all</u> liabilities at the later date, not just the environmental matters. In each case, buyer might exclude matters it gives notice of, as in the example PSA.

<u>Dollar Limitations on Liability</u>. The example PSA (and each rider where seller retains some liabilities), caps seller's liability under this section in two ways: (1) overall to what it was paid in the deal, and (2) on a property by property basis, to the value allocated to that property in Schedule I (allocation of values for due diligence/Defect process).

<u>Handling Disclosed Matters, Asserted Defects and Defects</u>. The example PSA (and each rider where seller retains some liabilities) excludes, from the matters seller retains responsibility for, liabilities relating to matters disclosed on the Disclosure Schedule. Seller will argue that disclosed items should have been taken into account by buyer. As a separate point, the example PSA (and each rider where seller retains some liabilities) also excludes liabilities relating to matters which were Asserted Defects or which buyer identified as Defects but chose not to assert (consistent with Section 7(d) of the example PSA). Seller will argue that the Defect process is the remedy that has been provided for these items (as Section 7(d) of the example PSA directly states, and as was discussed previously in connection with that section) and that, through the remedies provided for in the Defect process provisions, such matters have been taken into account, much like disclosed items. The example PSA (and each Rider where seller retains some liabilities) also has buyer assume liabilities related to these items (disclosed items, Asserted Defects and Defects identified but not asserted) with seller arguing that (1) they have been taken into account, either by buyer directly in its decisions to purchase and at what price because they were disclosed items, or through other remedies in the contract, and (2) if they are not seller's responsibility (because they were excluded from its responsibility for the reasons previously discussed) then they

should be buyer's responsibility and not fall in a crack between the two parties and leave seller unprotected from claims from third parties with regard to these matters. In the example PSA, this assumption may be hard to discern, but it works through the definition of Excluded Pre Closing Claims, as an exclusion from such claims.

Exclusion, Assumption. The situation discussed in the last couple of sentences of the previous paragraph highlights a broader point. Seller can exclude items from the liabilities it retains under the PSA, and not be responsible to buyer with respect to them. However, the provisions of the PSA have no effect on third parties, so seller will continue to have the same liabilities to third parties that it had before. While liabilities to third parties (and the possibility of being drawn into unpleasantries, including litigation, by those third parties) can't be avoided in how the PSA is drafted, the seller can get some protection with respect to these matters by having the buyer assume them in the PSA and indemnify seller with respect to them (as is done in the example PSA, at least after a period of time).

No Effect on Third Parties. In negotiating these provisions an important point to remember is that they have no effect on third parties. Even if the buyer assumes all liabilities, it isn't going to stop a third party from suing seller if it feels seller was the responsible party, has the deeper pockets, etc. While buyer, in that instance, has an obligation to seller to take care of the problem-and, if addressed in the PSA, an obligation to indemnify seller-it does not keep seller from being sued, or from having a primary obligation to a third party. Nothing drafted in a PSA can do that. Where buyer is of questionable financial standing, seller should be wary of putting too much faith in buyer's assumption of liabilities, for exactly the reasons discussed in this paragraph.

Survival. Often the obligations of buyer and seller under these provisions are provided to be in effect only for a limited period of time. After the closing, Seller may prefer this in its desire to rid itself of continuing obligations, at least at some point. However, if buyer has assumed seller's third party liabilities, it may not be the best result for seller if buyer's obligations to seller under this section are similarly limited. By limiting the survival of its obligations to buyer with respect to pre Effective Date matters (assuming seller retains some of these liabilities) seller limits the duration of its liability to buyer, but does not in any way limit its obligation to third parties (the same practical result as discussed in the "Exclusion Assumption" paragraph above). The potential result of both parties' obligations terminating at some time is that third parties can still pursue seller directly, and buyer can argue that it has no obligations to those parties. If successful, buyer may not need any obligation from seller to defend it from these third party claims because it may not have any liability for them in the first place. Thus, arguably, at least as regards pre-Effective Date liabilities, seller doesn't gain much from this limitation (it still gets sued by third parties) and buyer doesn't lose much (it still may escape liability, just another way). Looked at another way, assuming buyer negotiates for the same time limit on its obligations to seller under this section, then, to the extent buyer has assumed seller's third party liabilities, seller will still be obligated to the third parties (who can come after him directly in this case too) and, when buyer's obligations to seller expire, seller will no longer have any protection from buyer with respect to those third party liabilities.

One way to deal with this is to not have symmetrical survival provisions for buyer and seller. The example PSA provides that seller's obligations under this section will only survive for a limited period, but

that buyer's obligations will continue indefinitely. Buyer may well object to this asymmetrical approach, but seller will argue that future liabilities will continue to accumulate while historical liabilities should not grow, and will diminish, both as a practical matter and through the effect of limitation statutes.

Other Limitations. If (as in the example PSA and as an express item in one Rider) buyer assumes responsibility for matters arising out of the condition of the property, buyer may argue to exclude conditions for which it can be established that no post closing occurrences contributed to the condition. If the theory of buyer assuming such liabilities is that, generally, causation of problems arising out of property condition are difficult to pin down to time periods, then buyer will argue that there is some logic to excluding problems where it is in fact possible to pin down causation, and causation is wholly pre-effective date causation, Seller may propose to limit its obligations to buyer for pre Effective Date matters to liabilities arising during his period of ownership. This does have some benefit, particularly when retention of liabilities by seller is coupled with an indemnity, as it may at least free seller from indemnity liability in a case where the claimant sues the owner at time issue arose, and the current owner (the buyer) just to name parties. In such case, seller is not even a party. If this is done, seller will want buyer to assume those pre-Effective Date liabilities not expressly retained by seller. A PSA can also limit types of obligations that are retained or assumed by the parties, particularly in environmental context-such as limitations to clean up only, no fines, no consequential damages, etc. Other limitations may be possible as well.

Litigation. The existence of pending (presumably disclosed) litigation can be tricky to handle and may require special language, specific to the litigation items, in addition to the type of general assumption and indemnification language discussed here. Litigation is usually pretty fact specific, and so will not be discussed here, other than to note that where there is pending litigation, this point needs to be considered in negotiating assumption and indemnification provisions.

Indemnification for Representations. As noted above in the representations discussion, some buyers will want seller's indemnification to cover breaches of representations too. Neither the example PSA, nor any of the riders, provide for this. This is can be a significant expansion of seller's liability for such breaches and should be resisted by a seller.

Mechanics. There are many ways to write up the mechanics of an indemnification obligation, the example PSA contains one example. Some PSAs do not get into details on this point, preferring a short and simple PSA.

What if Nothing is Said? In thinking about this Section, it might be worth considering what the common law would provide if no provisions were made by the parties dividing up liabilities.

Casualty Losses

Casualty losses are an infrequent issue, but bear dealing with. In an oil and gas transaction, the likelihood is that only one or a few properties out of the group of properties in the deal are affected--unlike an office building sale where the casualty affects all the property in the deal, since there is

only one property. For this reason, the example PSA deals with casualty losses as matters that will, if one or more occurs, require handling, but should not derail the transaction.

It could be said that, as a practical matter, the example PSA allocates the risk of casualty loss to the buyer. Casualty losses are remedied through the Defect process and likely will not be large enough losses to trigger a right of buyer to unwind the transaction under section 9(c) for price adjustment limitations as buyer's closing condition.

The example PSA divides casualty losses into two parts: (1) losses to the oil and gas properties themselves, and (2) losses to equipment and facilities. In this division, losses to equipment are assumed to be of the type and dollar amount appropriate to be absorbed in the same manner as operating expenses (particularly if insurance proceeds are involved for larger losses). This assumption may not be valid for some properties and related facilities which should receive special consideration and attention- for example, perhaps offshore platforms. If this assumption is one the parties are unwilling to make, all casualty losses (or those related to some of the properties) could be treated just like losses to oil and gas properties.

The example PSA allows either party to elect to treat a casualty loss affecting the oil and gas properties as an Asserted Defect (failing such election, the loss is treated much like a loss involving equipment or facilities). This allows for a potential price adjustment to compensate buyer for the loss. It also allows for potential exclusion of the property under the Defect process, with a price adjustment for the full value allocated to such property for Defect process purposes. However, the deal still closes unless the price adjustments are large enough, when combined with the other Asserted Defect adjustments and adjustments for exercised preferential rights, to allow buyer to elect not to close under Section 9(c) for price adjustment limitations as buyer's closing condition. This should give buyer some comfort that, if there is a really large casualty loss, it does not have to close the deal.

The example PSA does not require seller to represent that it has any particular level of property insurance (or any property insurance at all), or covenant that it will maintain any insurance. This probably recognizes that insurance on the oil and gas properties themselves probably doesn't exist, and that many operators are, at least in effect, largely self insured with respect to the dollar level of losses likely to result from damage to equipment and facilities (absent a situation like an offshore platform or something similar). If this is the case, buyer is really just taking the risk of loss for equipment and facilities, as the example PSA is written, since there will be no price adjustment, seller isn't obligated to repair the equipment and facilities, and there is no insurance to rely upon. For damage to the oil and gas properties, buyer does get the opportunity for a price adjustment through the Defect process. Buyer may not like this, and may insist on a representation of certain levels of insurance and a covenant to keep them in force. If seller wants to avoid the insurance requirement, it could offer to treat all casualty losses like casualty losses to the oil and gas properties themselves.

Condemnation proceedings are sometimes lumped with casualty losses in real estate sales contracts, but they are not dealt with in the example PSA as they rarely affect oil and gas properties. And, at least arguably, they create title Defects which can be dealt with in the Defect process. Maybe more so than casualty losses, they are unlikely to justify scuttling the deal.

Survival of Provisions.

The parties will likely wish to agree that some PSA obligations will continue on after closing, while others will not. To some degree, the nature of the obligations (and time frames, deadlines, etc related to them in the PSA) solve this for themselves, but some agreed guidance for the parties is a good idea.

The example PSA provides that some of seller's, and all of buyer's, representations survive indefinitely (in general terms, these are representations related to the party's ability to do the deal), while the rest of seller's representations terminate after a period of time. As few seller representations as the example PSA contains, seller probably could allow all to continue indefinitely. As noted above in the discussion of representations, limiting survival can be an effective liability reduction device.

The example PSA also provides that seller's obligations under the assumption and indemnification section with respect to retained liabilities terminates at some point, while buyer's obligations under that section for assumed liabilities continues indefinitely. As the example PSA is written, this limitation on seller's obligations is less important as the liabilities seller retains responsibility for under that section shift to buyer at some point may unless buyer asserts them to seller before the shift. This frees seller therefrom as effectively as if a limitation on survival had been employed but without the negative implications that mirror image survival limitation provisions can create (as discussed above). Indeed buyer may argue that, given the arrangement under the assumption and indemnification section that seller will retain responsibility for items identified by buyer, a limit on survival of seller's obligations is inappropriate in that it conflicts with seller's agreement in that section to continue responsibility for those items identified by buyer (actually, the example PSA provides seller's responsibility in identified items continues indefinitely).

The Riders suggested in connection with other parts of the example PSA could allow curative action and the price adjustment process with respect to Defects, to continue past closing. It also allows for potential post closing activity in the price adjustment process for Defects if it is adopted as the remedy for representation breaches. These items, if included, would necessitate additional provisions in this section to deal with them.

Care needs to be taken to be sure the survival section works with the rest of the PSA. For example, in the example PSA the survival period for seller's obligations under Section 13 (assumption and indemnification) should not end before the shift of liabilities to buyer.

Miscellaneous

The repository for various provisions not put somewhere else. Going through the example PSA, here are some comments on sections that were included, and one that was not included:

Gas Imbalances. Buyer assumes the positions of seller. If gas balances were considered by buyer in making its offer, and adjustments made for unanticipated situations (either through defect or accounting adjustment process), then the existence of these positions have likely been considered and buyer probably should assume them. Also note, the riders discussed earlier (in connection with handling gas imbalances as "Defects" (Section 7) or accounting adjustments (Section 12) do not deal with pipeline imbalances, and do not necessarily deal with royalty accounting issues, but this section does. Seller will want buyer to assume these positions in any case.

Expenses, Damage Limitations, etc. This section limits seller overall damages to the price received, and on a property by property basis, to the amount attributed to the property for the Defect price adjustment process. This same limit is imposed in assumption and indemnification section and it is probably duplicative if both provisions stay in. Also, for both parties, this section excludes consequential damages, etc.

No Sales Taxes. As a practical matter, sales taxes are rarely (maybe never) collected in oil and gas deals. Some states provide general exemptions that should apply to most oil and gas transactions. Texas imposes a sales tax on sales of tangible personal property which includes the Christmas tree, wellhead and well components, flow lines, above ground gathering lines, pumpjacks, the rig, field processing equipment, etc. The Texas Comptroller of Public Accounts' general rule is that a sale of oil and gas property with related equipment located thereon will be considered a single sale of real property and Texas sales tax will not apply thereto. See e.g, Tex. Comp Ltrs. 981102IL (November 24, 1998), 9104L1104C01(April 11, 1991), and 8904L0934G11 (April 25, 1989). If the personal property is sold separately or is the main object of the sale, the personal property would be subject to Texas sales tax.

Some states do not provide exemptions. Oklahoma imposes a sales tax on tangible personal property, whether combined with real property or not. In such a case, the taxpayer must determine the amount of the purchase price that will subject to the Oklahoma sales tax based on the fair market value of the property. See Okla. Tax. Comm. Dec 99-03-25-012 (Mar. 25, 1999)(citing Magnolia Petroleum Co. v. Okla. Tax Commission, 326 P.2d 821 (Okla. 1958). This provision is added to cover sales tax whether or not an exemption to such tax applies.

Successors and Assigns-Certain Limitations. The language in the example PSA attempts to limit the parties with rights under certain sections of the PSA (representations and indemnities) to just buyer and seller. This is primarily intended to eliminate seller's obligations for these matters to persons on down the chain of title if buyer assigns properties and related contract rights. Seller probably has little likelihood of ever assigning its PSA rights so this limitation, though written to cover both parties, probably has little if any practical effect on seller.

Riders:

Potential Unwind: Some of the earlier Riders contemplate that price adjustments might continue post-closing. This could arise if due diligence or curative work extends past closing, thus

leading to possible adjustments for defects post closing, or if breaches of representations asserted post closing are to be treated as Defects, with related potential adjustments post closing. Where that can occur, it logically (but not necessarily) could bring into play the right the parties are given in the example PSA to not close (see Closing Conditions in Sections 9(c) and 10(c)) if purchase price adjustments are too great. After closing the only way to approximate that right is to provide for an unwind of the transaction. This Potential Unwind rider provides for the unwind and would not be used unless one of such other riders providing for post close adjustments was added to the agreement.

Like Kind Exchange: Some sellers will want to avoid capital gains tax by structuring a like kind exchange. Most buyers are agreeable to this so long as it is painless to them. The attached like kind exchange rider is intended to provide a simple paragraph that accomplishes this. More elaborate language is sometimes desired by the parties, but the goal remains the same, effectuate the exchange transaction aspect but don't burden the buyer.

No Press Release: A "no press release" provision is included as a Rider. As with the like kind exchange rider, more elaborate versions of this are sometimes desired by the parties.

Arbitration Not Included. No language on arbitration is included in the example PSA or Riders, but no commentary on the desirability of arbitration should be read into that. Arbitration could be the subject of a presentation all by itself proposing many variations of arbitration language for purchase and sale transactions, and it is beyond the scope of this presentation. It is noted that some PSAs do provide for arbitration and some don't depending on the preferences of the parties. Sometimes it is limited to specific issues-for example, Defect process or accounting adjustments (as discussed earlier)-sometimes it applies to any dispute under, or concerning, the PSA.

Exhibits and Schedules

These have been discussed as they came up in the text. Exhibit A and Schedule I attached to the example PSA contain brief examples of what they might need to look like to mesh with the text. As a general caution, a couple of places where PSAs sometimes fall short is that (1) exhibits and schedules are not carefully tailored to correspond with text of the PSA, and (2) data shown on exhibits and schedules is not carefully reviewed to be sure it is complete, accurate and does not contain things that shouldn't be there. Although this is somewhat more a buyer issue, disclosure schedules should be carefully reviewed as often the items disclosed are excepted from representations, and other obligations, in the PSA and may even form the basis for obligations taken on-this is certainly the case in the example PSA. In preparing an attached conveyance form (attached as Schedule II in the example PSA), the parties should verify that the description of assets conveyed corresponds with descriptions in PSA (Section 1 in example PSA). Often these paragraphs can be copied.

Conclusions

Every deal is different, and every seller (and buyer too, for that matter) has different motivations, concerns and personality-and the concerns and motivations will often vary from deal to deal even with the same seller. As was stated to begin with, this presentation, and the example PSA and riders, are not intended to be create a form, nor were they intended to highlight every issue of concern to a seller. Having said that, hopefully this presentation has been thought provoking and has at least offered up some useful ideas.