



# Closing the Deal in the Bayou State: The Purchase and Sale of Producing Oil and Gas Properties

Patrick S. Ottinger

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*Patrick S. Ottinger\**

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#### INTRODUCTION

The purchase and sale of producing oil and gas properties is a significant part of an oil and gas practice in Louisiana.<sup>1</sup> The term “producing oil and gas properties” encompasses not only the principal asset (the mineral lease) but also the equipment and wells that have been drilled pursuant to the mineral lease, as well as the panoply of agreements, licenses, permits, and other contractual rights assembled by the selling party in connection with the development and exploitation of the mineral lease. For a variety of reasons, a party who owns producing mineral leases might elect to divest itself of those interests.

The reasons leading a leasehold owner to a decision to divest might range from a desire to be relieved of future liabilities, or at least to pass along such obligations to another, to “quit” the business, or to commit capital to other ventures or enterprises. Additionally, in the current environment of depressed prices for oil and gas, many exploration and production (“E&P”) companies operating under a commercial line of credit are facing the certainty of a redetermination of their borrowing base

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1. Having practiced oil and gas law since the Spring of 1974, this Author has been involved in innumerable transactions of the type discussed here, involving the purchase and sale of producing properties in several states, totaling per transaction purchase prices ranging from smaller amounts to many millions of dollars. The total of all such transactions would be in the billions of dollars in the aggregate.

by their lender.<sup>2</sup> In turn, this fact makes prudent an examination of properties, which are not deemed to be “core,” to reduce secured debt by selling such properties and paying down debt. Regardless of the reason for divesting itself of the interest, producing oil and gas properties will still have significant value, especially to those who are able to put them to a more profitable use.

Although a major oil and gas—or even a large independent—company might deem a producing property to no longer be profitable according to its own internal financial yield or performance requirements, a smaller independent company can often find significant value in the same suite of assets. The smaller company may believe that it can operate the field more efficiently or economically by lowering the per-barrel “lifting costs,”<sup>3</sup> or other expenses of operation, at least in comparison to the seller. This marginal cost reduction is sometimes called “working the margins.”

Typically, the sale—and concomitant purchase—of producing oil and gas properties entails several distinct phases: the announcement by the seller of an intent to divest and consequential solicitation of potential bidders; the preliminary evaluation of the assets being offered for sale; the arrangement of preliminary terms, perhaps to be embodied in a “letter of intent”; the negotiation and execution of a formal purchase and sale agreement; the performance of “due diligence” on the part of the purchaser; the closing of the transaction; and post-closing adjustments. These necessary actions do not happen overnight, and each phase comes with its own legal complications.

Several excellent papers have been delivered at the Louisiana Institute on Mineral Law on this general topic, as well as on distinct aspects of the transaction.<sup>4</sup> At the Institute on Oil and Gas Law, which The Institute for

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2. “The borrowing base for O&G loans is the estimated value of O&G that can be produced from the mineral rights. It is determined by analyzing prior production reports and independent engineering valuations.” OFFICE OF THE COMPTROLLER OF THE CURRENCY, OIL AND GAS PRODUCTION LENDING 17, 56 (2014), available at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-a-og.pdf>. It is a “collateral base agreed to by the borrower and lender that is used to limit the amount of funds the lender advances the borrower. *Id.* The borrowing base specifies the maximum amount that can be borrowed in terms of collateral type, eligibility, and advance rates.” *Id.* Typically, but not universally, the amount of the loan would be based upon 80% of the value of the borrower’s assets, supported by reserve reports, title opinions, etc. *Id.*

3. This term has reference to those costs incurred by the operator, and which are “necessary to lift the oil from the ground.” *Stewart v. Amerada Hess Corp.*, 604 P.2d 854, 857 n.8 (Okla. 1979).

4. See, e.g., Thomas G. Bateman, Jr., *Representing Sellers and Buyers in the Sale of Producing Properties: Fundamentals of the Acquisition Process*, 34 ANN.

Energy Law of The Center for American and International Law sponsors, other fine journals have made other informative presentations.<sup>5</sup> Recent developments, principally the spate of sales necessitated by the volatile price of oil and gas and the concomitant pressure on companies to reduce debt, suggest that now might be an appropriate time to take a more contemporary look at the issues that might arise in the Bayou State.

A sufficient presentation on this topic could be accomplished by merely reviewing and discussing the various terms and provisions commonly contained in the customary purchase and sale agreement (“PSA”),<sup>6</sup> without looking “under the hood.” An understanding of the legal principles that embrace or support the salient clauses in the PSA, however, is necessary to gain an insight into the import of those provisions, as well as the legal requirements, if any, that are necessary in respect of any particular contractual stipulation.

Fortunately, in many transactions, the “deal is closed” without the need to give any significant consideration to these important matters. In the unfortunate instance when the parties are not able to “close the deal,” the occasion arises to resort to the law books to evaluate the respective rights and obligations of the parties. A great deal can be said for knowing

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INST. ON MIN. L. 163 (1987); Paul A. Strickland, *Merchantable Title and the Mineral Lease*, 40 ANN. INST. ON MIN. L. 236 (1993); Robert L. Cabes, *Rights and Obligations of Third Parties in the Acquisition of Oil and Gas Properties*, 40 ANN. INST. ON MIN. L. 249 (1993); Don Sinex, *Seller’s Duty to Disclose to Buyer*, 47 ANN. INST. ON MIN. L. 197 (2000); Anthony C. Marino, *Current Developments in Producing Property Acquisitions: The Role of the Title Examiner in Acquisitions & Frequently Encountered Lease Form Provisions*, 59 ANN. INST. ON MIN. L. 25 (2012).

5. See, e.g., Harry C. Weeks, *Advantageous Methods of Handling the Purchase of Oil and Gas Properties*, 3 INST. ON OIL & GAS L. & TAX’N 387 (1952); Manro T. Oberwetter, *The Sale and Purchasing of Producing Properties*, 9 ROCKY MTN. MIN. L. INST. 403 (1963); Jack E. Earnest, *Sale and Purchase of Oil and Gas Properties*, 16 INST. ON OIL & GAS L. & TAX’N 189 (1965); Phillip R. Clark, *Producing Property Acquisitions: Legal and Practical Considerations*, 37 INST. ON OIL & GAS L. & TAX’N 9-1 (1986); James L. Irish, *Structuring Acquisitions of Oil and Gas Properties: Significant Considerations in Deciding Whether to Purchase a Company or to Purchase Its Assets*, 40 INST. ON OIL & GAS L. & TAX’N 2-1 (1989); Richard C. Rice, *Sales Agreements for the Disposition of Oil and Gas Properties: A Seller’s Perspective*, 46 INST. ON OIL & GAS L. & TAX’N 5 (1995); David Patton, *Purchasing Onshore Oil and Gas Assets (The Buyer’s Perspective)*, 59 INST. ON OIL & GAS L. 12 (2008).

6. In the jargon of the industry, and frequently herein, the purchase and sale agreement is commonly called simply the “PSA.”

the fundamental, relevant rules before the deal goes south in the Bayou State.

This Article presents a broad overview of the most important rules and legal issues surrounding the purchase and sale of producing properties in Louisiana. Part I considers the fundamentals of the purchase and sale of producing properties, including the nature of producing properties and the factors that motivate a party to sell its producing mineral leases. As the Article examines this topic in the Bayou State, attention is given to the sources of laws. Part II examines pertinent provisions of the Louisiana Mineral Code as they relate to the assignment of mineral leases. Part III expands the examination of applicable law to include the relevant provisions of the Louisiana Civil Code, particularly the nominate contract of sale. As the purchase and sale of producing oil and gas properties is to be evidenced by a written agreement, Part IV takes up the contractual provisions typically encountered in purchase and sale agreements. This Part also explains in detail the steps taken in anticipation of a closing. Finally, the Article considers the range of remedies available to the parties in the regrettable circumstance that a transaction is not consummated as contemplated by the PSA.

#### I. FUNDAMENTALS OF THE SALE OF PRODUCING OIL AND GAS PROPERTIES

To understand the nuances of a PSA involving producing oil and gas properties in Louisiana, one must first have a firm grasp on the legal foundations underlying such agreements. This task is challenging, because a complex network of statutes, regulations, and jurisprudential rules govern mineral interests in the Bayou State. For this reason, this Part will discuss the nature of producing oil and gas properties as well as the sale of such properties in practice.

##### *A. The Nature of Producing Oil and Gas Properties*

Fundamentally, the sale of producing oil and gas properties is the sale of immovable property,<sup>7</sup> at least so far as the principal asset is concerned. The principal asset is the mineral lease because without that vital agreement, the right to be on the property of another—and to produce oil and gas from that property—generally does not exist.<sup>8</sup>

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7. “A mineral [lease] is an incorporeal immovable. It is alienable and heritable.” LA. REV. STAT. ANN. § 31:18 (2000); *see also id.* § 31:16.

8. *Id.* § 31:114 (“A mineral lease is a contract by which the lessee is granted the right to explore for and produce minerals.”). *But see id.* § 31:21 (“A mineral

Certainly other important rights and interests are involved and necessarily transferred, and such rights and interests are not always subject to the laws pertaining to the alienation of immovable property.<sup>9</sup> As important and as critical as such interests are for the prudent operation of the producing field, however, they intrinsically follow or trail the disposition of the principal asset—the mineral lease. Without the ownership of the mineral lease, the ancillary rights or interests, standing alone, are relatively inconsequential and certainly are not sufficient to confer upon the purchaser the right to operate on the land and to produce hydrocarbons.<sup>10</sup>

### *B. Sales Involving Producing Oil and Gas Properties in Practice*

The sale of producing oil and gas properties is essentially contractual: most “deals” live or die with the PSA. The PSA is the “sophisticated” contract, which undertakes to anticipate and cover all contingencies that might potentially arise between the seller and the purchaser.

Both in practice and in law, there is rarely a need to “go to the law books,” that is, to evaluate the reason why a particular action is done or not done in a strict legal sense. Even so, having a basic understanding of why “this works” or “that does not work” in the negotiation or execution of a PSA or in its administration is still important.

With this observation, giving consideration to the fundamental “ground rules” that might come into play in connection with the sale of producing oil and gas properties is appropriate. The proper starting point is the statutory or codal law of Louisiana.<sup>11</sup>

### *C. The “Hierarchy of Pertinent Law”<sup>12</sup>*

Heaven forbid that a dispute should arise and that the transaction is not perfectly consummated as contemplated by the PSA. The seller can blame the purchaser, and certainly *vice versa*, but the dispute exists. In a PSA, which is governed by Louisiana law, the “ground rules” are provided

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servitude is the right of enjoyment of land belonging to another for the purpose of exploring for and producing minerals and reducing them to possession and ownership.”).

9. Examples of these “other important rights” would include servitude agreements (sometimes called “rights-of-way”) and other contracts in support of operations or production.

10. See *supra* note 8.

11. LA. CIV. CODE art. 1 (2015) (“The sources of law are legislation and custom.”).

12. Portions of this section constitute an adaptation of PATRICK S. OTTINGER, LOUISIANA MINERAL LEASES — A TREATISE ch. 3, pt. I (forthcoming 2016).



by applicable law. What are the “ground rules” to evaluate the position of each party?

As in any dispute, an established “hierarchy of law” supplies the principles to resolve the controversy, depending on its nature. Louisiana Mineral Code article 2 provides the starting point for this hierarchy:

The provisions of this Code are supplementary to those of the Louisiana Civil Code and are applicable specifically to the subject matter of mineral law. In the event of conflict between the provisions of this Code and those of the Civil Code or other laws the provisions of this Code shall prevail. If this Code does not expressly or impliedly provide for a particular situation, the Civil Code or other laws are applicable.<sup>13</sup>

As pertaining to mineral leases—and contracts to which they pertain—this direction to turn to the Mineral Code, rather than to the “Civil Code or other laws” in matters of mineral law, is concordant with Louisiana Civil Code article 2672, which provides that a “mineral lease is governed by the Mineral Code.”<sup>14</sup>

If the Mineral Code “does not expressly or impliedly provide for a particular situation, the Civil Code or other laws are applicable.”<sup>15</sup> In this sense, other provisions in the Civil Code and the Revised Statutes are said to be “suppletive” to the Mineral Code in that those sources will “fill in the blanks” if the Mineral Code does not provide an answer or guidance with regard to a particular issue under the mineral law of this state.<sup>16</sup>

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13. LA. REV. STAT. ANN. § 31:2.

14. LA. CIV. CODE art. 2672.

15. LA. REV. STAT. ANN. § 31:2.

16. The distinction between an “imperative” law and a “suppletive” law has been explained by the Louisiana Supreme Court as follows:

Statutory rules may be either imperative or suppletive. Rooted in public policy considerations, an imperative rule is applied without regard to the intention of the individuals concerned. A prohibitory law . . . is one that is cast in the imperative form, but exhibits a negative, rather than positive, command. . . . A suppletive rule, on the other hand, applies only if those affected by it have not excluded its application. . . . Thus, distinction between imperative and suppletive rules determines whether private individuals can set aside rules established by the legislature and regulate their legal relations by private agreement. If an agreement contravenes an imperative rule, it is absolutely null; thus, it is not subject to ratification and may be annulled in judicial proceedings instituted by any interested party.

E. L. Burns Co. v. Cashio, 302 So. 2d 297, 300 (La. 1974) (footnotes omitted).

A recognized hierarchy exists for the resolution of an issue pertaining to a controversy or dispute between a seller and purchaser of mineral leases under a PSA: (1) the PSA itself, as the “law between the parties”;<sup>17</sup> (2) the Louisiana Mineral Code, if the PSA does not address a particular “subject matter of mineral law”;<sup>18</sup> (3) the Civil Code, the Revised Statutes, or “other [applicable] laws,” if the Louisiana Mineral Code “does not expressly or impliedly provide for a particular situation”;<sup>19</sup> (4) if neither the purchase and sale agreement nor legislation address a particular subject or issue, resort may be had to custom and usages of the industry;<sup>20</sup> and (5) if neither the PSA nor legislation nor custom “provide for a particular situation,” reference may be had to equitable considerations.<sup>21</sup>

*D. Influence of Decisions of Other States*<sup>22</sup>

Because of the nature of the oil and gas industry, and in recognition of the fact that certain issues, practices, and agreements are common in many oil and gas producing states, the courts of Louisiana have occasionally taken cognizance of the published decisions of other states where a particular issue has not previously been considered by a court in Louisiana. This is particularly true with respect to the alienation of a mineral lease, in contrast to the mineral servitude or mineral royalty, because of the functional similarity of the Louisiana mineral lease to the lease contract in other states. More importantly, although the mineral lease is also contractually based, the other types of mineral rights are essentially codally based.<sup>23</sup>

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17. “Contracts have the effect of law for the parties.” LA. CIV. CODE art. 1983.

18. LA. REV. STAT. ANN. § 31:2.

19. *Id.*

20. “Custom results from practice repeated for a long time and generally accepted as having acquired the force of law. Custom may not abrogate legislation.” LA. CIV. CODE art. 3; *see also id.* art. 2054. This last cited article “applies in circumstances where the contract is not ambiguous or doubtful, but simply fails to address a particular question.” *Ellwood Oil Co. v. Anderson*, 655 So. 2d 694, 697 (La. Ct. App. 1995).

21. “When no rule for a particular situation can be derived from legislation or custom, the court is bound to proceed according to equity. To decide equitably, resort is made to justice, reason, and prevailing usages.” LA. CIV. CODE art. 4.

22. Portions of this Section are an adaptation of Patrick S. Ottinger, *From the Courts to the Code: The Origin and Development of the Law of Louisiana on Mineral Rights*, 1 LSU J. ENERGY L. & RESOURCES 5 (2012).

23. The intrinsic attributes of a mineral servitude and a mineral royalty are set forth in the Mineral Code with limited opportunity to alter those principles. In

As the Louisiana Supreme Court has stated, “[a]lthough the decisions of other jurisdictions are not controlling on the Courts of Louisiana, if they determine an issue practically identical with the one under consideration, they possess at least a persuasive effect and merit attention.”<sup>24</sup> The most prominent example of the influence of a foreign court on an important issue under Louisiana mineral law is the recognition that the Louisiana law pertaining to the doctrine of production in “paying quantities” finds its genesis in a ruling of the Supreme Court of Texas.<sup>25</sup> Indeed, as noted in the official comment to Mineral Code article 124, Louisiana’s current law on this subject is fashioned in large part on the pronouncements of the Supreme Court of Texas in *Clifton v. Koontz*.<sup>26</sup> Beyond that particular concept, Louisiana courts have considered cases from other oil and gas producing states in litigation over royalty payments based upon “market value,”<sup>27</sup> the treatment of “post-production costs,”<sup>28</sup> and the interpretation of the model form operating agreement.<sup>29</sup>

A number of cases involving the purchase and sale of producing oil and gas properties have been decided under the laws of other states, particularly if no Louisiana case has addressed the issue.<sup>30</sup> It must be understood, however, that a sales transaction governed by Louisiana law would be controlled by the substantive provisions of the Civil Code relative to sale, and would not be governed by principles of law of another

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contrast, the mineral lease is a contract, and the principles of “freedom of contract” apply with minimal limitations arising out of public policy.

24. *C H F Fin. Co. v. Jochum*, 127 So. 2d 534, 539 (La. 1961); *see also Michiels v. Succession of Gladden*, 180 So. 862, 864 (La. Ct. App. 1938), *aff’d*, 183 So. 217 (1938).

25. *See* LA. REV. STAT. ANN. § 31:124 cmt. (2000).

26. 325 S.W.2d 684 (Tex. 1959); *see also* Patrick S. Ottinger, *Production in “Paying Quantities”—A Fresh Look*, 65 LA. L. REV. 635 (2005); Patrick S. Ottinger, *Production in “Paying Quantities”—A Fresh Look*, 51 ANN. INST. ON MIN. L. 24 (2004).

27. *See, e.g., Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334, 1337 (La. 1982) (“We note that the same or similar contract language has often been interpreted by the courts of other jurisdictions . . . .”); *Shell Oil Co. v. Williams, Inc.*, 428 So. 2d 798, 801 (La. 1983) (“In our review of the jurisprudence of other jurisdictions, we note that the Texas Supreme Court and the United States Court of Appeals, Fifth Circuit, have addressed this issue.”).

28. *Henry*, 418 So. 2d at 1336 (citing, but not following, *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968)).

29. *See, e.g., Clovelly Oil Co. v. Midstates Petroleum Co.*, 112 So. 3d 187 (La. 2013). In the interest of full disclosure, your Author represented certain *amici curiae* in this suit.

30. *See infra* Part III.C.3.

state.<sup>31</sup> Still, these other cases are helpful to the extent that they consider and explain the meaning and purpose of certain clauses or provisions that are customary to PSAs in common use in this sector of the oil and gas industry.

## II. PROVISIONS OF THE LOUISIANA MINERAL CODE PERTINENT TO THE SALE AND ASSIGNMENT OF MINERAL LEASES

When the intent of the parties to a PSA of producing properties is not to the contrary, considering some important provisions of the Louisiana Mineral Code that are pertinent to the purchase and sale of mineral leases is essential. In fact, some of these provisions may not be altered by contract because they are rules of public order.<sup>32</sup> This Part will examine some important Mineral Code rules as well as their relation to provisions in other areas of Louisiana law.

### *A. The Alienability of a Mineral Lease*<sup>33</sup>

A little over a century ago, the Louisiana Supreme Court considered—and rejected—a contention that a contract for the exploration and development of minerals<sup>34</sup> was not assignable on the asserted theory that such contract was “personal on the part of the obligor.”<sup>35</sup> This suggestion was based on the lessor’s contention that “the obligation ‘to drill with a view to finding commercial substances’ is purely personal on the part of the obligor.”<sup>36</sup> The court did not consider this argument, determining that the “contract does not purport to impose any such obligation on [the obligor].”<sup>37</sup> The lessor then urged that the contract was not assignable because “no mention is made in it of assigns, or of the right to assign.”<sup>38</sup> This argument—that contractual silence or omission resulted in a negation of the right to assign—was summarily rejected by the Court:

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31. *See infra* Part IV.J.3.

32. *See infra* Part II.B.

33. Portions of this section constitute an adaptation of OTTINGER, *supra* note 12.

34. At the time of this decision, the courts had not fully determined the juridical or legal character of what is now recognized as a “mineral lease.” For the history of the development of the mineral lease in Louisiana, see William M. Hall, *The Juridical Nature of the Mineral Lease*, 11 ANN. INST. ON MIN. L. 106 (1964).

35. *Anse La Butte (Le Danois) Oil & Mineral Co. v. Babb*, 47 So. 754, 755 (La. 1908).

36. *Id.*

37. *Id.*

38. *Id.*

But, manifestly, there was no need of any such mention, since a man may assign whatever right not purely personal to himself he may be the owner of. The rule is that all things of value, incorporeal as well as corporeal, may be made the subject of sale.<sup>39</sup>

Thus, being a “thing of value,” or an item of commerce, a mineral lease is freely assignable. Today, a series of articles in both the Louisiana Mineral Code and the Louisiana Revised Civil Code establish this uncontroversial proposition.<sup>40</sup>

*B. Inapplicability of the Remedy of Lesion Beyond Moiety*<sup>41</sup>

A necessary corollary of the fact that a mineral lease is a “real right”<sup>42</sup> and an “incorporeal immovable”<sup>43</sup> is that all laws pertinent to immovable property with certain limited exceptions apply to a mineral lease.<sup>44</sup>

One law applicable to the sale of immovable property in general, but which does *not* apply to the sale or assignment of a mineral lease, is the vendor’s remedy of lesion beyond moiety.<sup>45</sup> Lesion beyond moiety involves a seller’s rescission of a sale of a corporeal immovable “when the price is less than one half of the fair market value of the immovable.”<sup>46</sup> Louisiana Mineral Code article 17 states that a “sale of a mineral [lease] is not subject to rescission for lesion beyond moiety.”<sup>47</sup> The reason for this rule is that, by their very nature, the valuation and the existence of minerals is highly speculative.<sup>48</sup>

39. *Id.* (citing LA. CIV. CODE art. 2448 (1870)).

40. *See, e.g.*, LA. REV. STAT. ANN. §§ 31:18, :127 (2000); LA. CIV. CODE arts. 454, 470, 1984, 2448 (2015).

41. Portions of this section constitute an adaptation of OTTINGER, *supra* note 12, ch. 2, pt. I.

42. LA. REV. STAT. ANN. § 31:16.

43. *Id.* § 31:18.

44. “Mineral rights, including mineral leases, are classified under the Mineral Code as incorporeal immovables and are subject to the Civil Code articles respecting immovable property.” *Guy Scroggins, Inc. v. Emerald Exploration*, 401 So. 2d 680, 684 (La. Ct. App. 1981). In the interest of full disclosure, your Author represented the defendant in this suit.

45. LA. REV. STAT. ANN. § 31:17.

46. LA. CIV. CODE art. 2589 (2015).

47. LA. REV. STAT. ANN. § 31:17.

48. *See McCoy v. Ark. Natural Gas Co.*, 165 So. 632, 633 (La. 1936) (“A review of the cases on that subject-matter shows that damages were not allowed because of the uncertain and speculative nature of the loss complained of. One of the reasons which we assigned in this case when it was previously before us for sustaining the exceptions of no cause and no right of action was that ‘the loss

Although lesion does not apply to the “sale of a mineral [lease],”<sup>49</sup> one should note that this article is probably not needed because “[l]esion can be claimed only by the seller and only in sales of *corporeal* immovables.”<sup>50</sup>

### *C. Other Consequences Arising Out of the Assignment of the Mineral Lease*

Each of the articles that follow article 127 of the Louisiana Mineral Code address distinct consequences arising out of an assignment or sublease of a mineral lease, and they do not differentiate themselves in reference to one type of transfer from the other.<sup>51</sup> These consequences pertain principally to the assignment, not the PSA.<sup>52</sup> Although important, these are beyond the scope of this Article. The reader may, however, refer to another Article by this Author for greater edification of these matters.<sup>53</sup>

## III. PROVISIONS OF THE LOUISIANA CIVIL CODE PERTINENT TO THE SALE AND ASSIGNMENT OF MINERAL LEASES

Because the sale of producing properties will invoke the law of the Bayou State, it is instructive to examine the various types of agreements that might be involved in this transaction. An array of agreements might be entered into by the parties in anticipation of a purchase and sale of producing properties. Fundamentally, the Louisiana Civil Code recognizes types of agreements that are preparatory to the sale, as well as agreements of sale. A sale is a “nominate contract,” which is defined in Louisiana Civil Code article 1914 as being “those [contracts] given a special designation such as sale, lease, loan, or insurance.”<sup>54</sup> That same codal authority informs that other agreements associated with the sale may be classified as “innominate,” as they “are those [contracts] with no special designation.”<sup>55</sup>

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complained of was, manifestly, more a matter of uncertainty and speculation than of fact or estimate.”).

49. LA. REV. STAT. ANN. § 31:17.

50. LA. CIV. CODE art. 2589.

51. Each article treats of both assignments and subleases, referencing both an assignor and an assignee, and a sublessor and a sublessee, thus indicating that the subject matter of each article pertains to both types of conveyance.

52. As will be seen, the PSA is a contract to sell, not the sale itself.

53. Patrick S. Ottinger, *What's in a Name? Assignments and Subleases of Mineral Leases Under Louisiana Law*, 58 ANN. INST. ON MIN. L. 283 (2011).

54. LA. CIV. CODE art. 1914.

55. *Id.*

*A. Applicability of the Law of Sales*

At its core, the sale of producing oil and gas properties is the sale of immovable property. Although the principal asset involved in a transaction embodied in a PSA pertaining to producing oil and gas properties is subject to the law of lease, the alienation of that asset is indisputably addressed in the context of the law of sale. “Sale is a contract whereby a person transfers ownership of a thing to another for a price in money.”<sup>56</sup> Indeed, in the vernacular, the sale of producing oil and gas properties is the sale of “real estate,” such that case law dealing with the purchase and sale of land—or even of a residence or commercial building—is pertinent. Therefore, cases involving sale agreements of land can provide guidance on related issues.

The terms of the PSA, however, may subject it to some other area of Louisiana law. For example, if an overriding royalty interest or some other form of control is reserved, the transaction is, in legal contemplation, a sublease, not a sale.<sup>57</sup> A sublease is essentially a “lease of a lease,” with the result that the law of lease would be the controlling regime. The Supreme Court has stated that a “sublessor . . . assumes all rights, interest, obligations, penalties, etc., enjoyed by and granted to the original lessor.”<sup>58</sup>

*B. Agreements Preparatory to the Sale*

Some agreements may be made in preparation of a sales contract. The Louisiana Civil Code recognizes three particular types of such agreements: an option, a contract to sell, and a right of first refusal. Although each type of agreement preparatory to sale is subject to distinct rules, which are detailed below, it is important to note some common governing principles that apply to all of these agreements.

Some common governing principles of agreements preparatory to sale are especially important for the present discussion. For one, all nominate agreements preparatory to sale involving immovables have limited effectiveness against third persons: “An option, right of first refusal, or contract to sell that involves immovable property is effective against third persons only from the time the instrument that contains it is filed for registry in the parish where the immovable is located.”<sup>59</sup> Secondly, the option and right of first refusal are subject to additional limitations regarding

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56. *Id.* art. 2439.

57. *See* *Smith v. Sun Oil Co.*, 116 So. 379, 380 (La. 1928); *Berman v. Brown*, 70 So. 2d 433, 445–46 (La. 1953).

58. *Wier v. Grubb*, 82 So. 2d 1, 7 (La. 1955).

59. LA. CIV. CODE art. 2429.

permissible terms and divisibility. As for permissible terms, “[a]n option or a right of first refusal that concerns an immovable thing may not be granted for a term longer than ten years.”<sup>60</sup> As for divisibility, “[t]he right to exercise an option and the right of first refusal are indivisible. When either of such rights belongs to more than one person all of them must exercise the right.”<sup>61</sup> In addition to these general governing principles, each of the nominate agreements preparatory to sale having particular governing principles.

### 1. Option

An option to buy or sell is defined as “a contract whereby a party gives to another the right to accept an offer to sell, or to buy, a thing within a stipulated time.”<sup>62</sup> The requirements of an option mirror the requirements of the sale it contemplates, including specification of the thing, specification of the price, and meeting relevant form requirements.<sup>63</sup> As the Louisiana Civil Code makes clear, “[t]he acceptance or rejection of an offer contained in an option is effective when received by the grantor.”<sup>64</sup> Although “[r]ejection of the offer contained in an option terminates the option,” an acceptance binds the parties to a contract to sell.<sup>65</sup> In addition, an acceptance brings about certain warranties of the assignor by operation of law: “The assignor of an option to buy a thing warrants the existence of that option, but does not warrant that the person who granted it can be required to make a final sale.”<sup>66</sup>

Although the requirement of a further act following acceptance of the option seems indispensable for immovables, it would also appear to make perfect sense for the transfer of certain movables, such as a drilling rig or shares of stock. At any rate, this rule is not mandatory, and the parties are always at liberty to provide otherwise in their agreement.<sup>67</sup> It is not typical to encounter an option to sell producing oil and gas properties, principally for the reason that the risk of fluctuation of value would be on the optionor-

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60. *Id.* art. 2628 (“Nevertheless, if the option or right of first refusal is granted in connection with a contract that gives rise to obligations of continuous or periodic performance, an option or a right of first refusal may be granted for as long a period as required for the performance of those obligations.”).

61. *Id.* art. 2630.

62. *Id.* art. 2620.

63. *Id.*

64. *Id.* art. 2621.

65. *Id.* A counteroffer does not terminate the option. *Id.*

66. *Id.* art. 2622 (“If, upon exercise of the option, the person who granted it fails to make a final sale, the assignee has against the assignor the same rights as a buyer without warranty has against the seller.”).

67. *See id.* arts. 7, 1983.



seller, not on the optionee-purchaser who enjoys the ability to enforce a sale by exercising the option or simply walk away with impunity.<sup>68</sup>

### 2. *Contract to Sell*

The contract to sell is defined as “[a]n agreement whereby one party promises to sell and the other promises to buy a thing at a later time, or upon the happening of a condition, or upon performance of some obligation by either party.”<sup>69</sup> Thus, such a contract does not immediately transfer ownership of the thing. The contract does, however, “give[] either party the right to demand specific performance.”<sup>70</sup> Like the option, a contract to sell “must set forth the thing and the price, and meet the formal requirements of the sale it contemplates.”<sup>71</sup>

### 3. *Right of First Refusal*

The “right of first refusal” is an arrangement that is both common and important to the parties. The exercise of a right of first refusal would result in the subtraction of an asset from the transaction and a concomitant reduction in the purchase price. By the same token, if the holder of a preferential right of purchase is not properly and timely notified, its rights are not diminished and litigation could ensue after the closing of the transaction. These issues, and others, are an important component of both due diligence and closing the transaction.

#### a. *General*

The “right of first refusal,” *pacte de préférence*, is a unilateral juridical act whereby “[a] party . . . agree[s] that he will not sell a certain thing without first offering it to a certain person,” which “may be enforced by specific performance.”<sup>72</sup> As the Louisiana Civil Code makes clear, “[t]he grantor of a right of first refusal may not sell to another person unless he has offered to sell the thing to the holder of the right on the same terms, or on those specified when the right was granted if the parties have so agreed.”<sup>73</sup> Thus, the grantor of a right of first refusal (unlike the grantor of

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68. Of course, the doctrine of “freedom of contract” would permit contracting parties to construct an opportunity for the optionor to terminate, or even foreclose the optionee’s exercise of, the option if values of product reach a certain level.

69. *Id.* art. 2623.

70. *Id.*

71. *Id.*

72. *Id.* art. 2625.

73. *Id.* art. 2626.

an option) is only conditionally bound to enter into a contract of sale if and when that person is contemplating selling to another.

The right of first refusal is subject to default (suppletive) temporal limitations based on the nature of the object of the right: “Unless otherwise agreed, an offer to sell the thing to the holder of a right of first refusal must be accepted within ten days from the time it is received if the thing is movable, and within thirty days from that time if the thing is immovable.”<sup>74</sup> If the grantor fails to conclude a sale or contract to sell with a third person within six months of the grantee being able to exercise its right of first refusal, however, that right will subsist even if the grantee failed to exercise it.<sup>75</sup>

*b. “Pref Rights” in the Industry*

Finding that the properties are subject to a “preferential right to purchase”—often called a “pref right” in the jargon of the industry—is not uncommon.<sup>76</sup> Indeed, the model form operating agreement, which is prevalently used in Louisiana, contains a “preferential right to purchase” provision, although parties are free to delete it.<sup>77</sup>

Case law in Louisiana enforces these types of arrangements, and it is an ordinary and necessary part of due diligence to, first, identify these rights, and then to seek to secure a waiver or lapse of time without exercise of a “pref right.” Case law in Texas explains the “pref right,” as follows:

A preferential right, also known as a right of first refusal or preemptive right, is a right granted to a party giving him or her the first opportunity to purchase property if the owner decides to sell it. A preferential right has been described as a dormant option. Once the property owner conveys the terms of the offer to the

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74. *Id.* art. 2627.

75. *Id.*

76. See Robert J. Sergesketter, *Preferential Rights to Purchase: The Basics, and the Most Interesting Pref. Rights Case You’ve Never Heard About*, HOUS. L. REV.: OFF THE RECORD, Spring 2015, at 43, 46 (“First, let us get some nomenclature out of the way. Preferential Rights to Purchase often are referred to as Rights of First Refusal, or ‘RoFRs.’ They also are referred to as Preferential Purchase Rights (the naming convention primarily used in this Article), Preferential Rights, Pref. Rights, Preemptive Rights, and Contingent Rights.”).

77. A widely used form of operating agreement (in the Bayou State and elsewhere), is the AAPL Form 610—the Model Form Operating Agreement published by the American Association of Professional Landmen (AAPL). First introduced in 1956 at its Annual Meeting in Denver, Colorado, revised forms were issued by the AAPL in 1977, 1982 and 1989.

rightholder, the rightholder then has the power to accept or reject the offer. Thus, when the property owner gives notice of his intent to sell, the preferential right matures or “ripens” into an enforceable option.<sup>78</sup>

The offer to purchase must strictly abide by the requirements of the agreement. For example, a violation of a right of first refusal (“ROFR”) contained in an operating agreement was found in *Fordoche, Inc. v. Texaco, Inc.*<sup>79</sup> In that case, the ROFR clause of the Joint Operating Agreement (“JOA”) provided as follows:

Before the sale to a third party by any Operating Party of its interest, in whole or in part, in the properties affected by this agreement, the other Operating Parties shall be given the refusal thereof at the best price offered in good faith by a third party, and such other Operating Parties shall have the preferred right to purchase at the price stated, which right shall be exercised within thirty (30) days after receipt of written notice of the offer made by a third party . . . .<sup>80</sup>

The court noted that “[i]t is self-evident that the 1962 [JOA] extends appellants’ ROFR to TEPI’s entire working interest in its mineral leases subject to that JOA. The text of that agreement provides, ‘before the sale to a third party . . . of *its interest* . . . in *the properties affected* by this agreement.’”<sup>81</sup> The court held that “TEPI violated the August 29, 1962 JOA by failing to offer the entirety of its interest in the property affected by the JOA to the Fordoche group, yet thereafter selling the entirety to a third-party buyer, EnerVest.”<sup>82</sup>

Unique and difficult issues arise in a “package sale” involving multiple fields where the ROFR burdens less than all of the properties proposed to be sold by the seller. The necessity arises to allocate values among the properties, so that any exercise of a “pref right” can be effectuated on an equitable basis. The courts in Texas do not require a holder of a preferential right to also acquire other assets in the “package,”

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78. *FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P.*, 301 S.W.3d 787, 793 (Tex. App. 2009) (citations omitted).

79. 463 F.3d 388 (5th Cir. 2006).

80. *Id.* at 393.

81. *Id.* (emphasis in original).

82. *Id.*

which were not subject to the “pref right” but were offered with the assets burdened by the right.<sup>83</sup>

Additionally, issues may be presented if, rather than selling the affected assets, a party divests the property by involuntary sales,<sup>84</sup> by donations, or by entering into a transfer of the stock of the record title owner. This important component of a PSA has been the subject of commentary<sup>85</sup> as well as litigation in the Bayou State.

In *Fina Oil and Chemical Co. v. Amoco Production Co.*,<sup>86</sup> Fina, the non-operator, and Amoco, the operator, owned certain mineral leases in equal indivision.<sup>87</sup> The leases were subject to a joint operating agreement, which contained a “preferential right to purchase” provision.<sup>88</sup> In connection with a corporate reorganization, Amoco transferred the entirety of its interest to a subsidiary corporation, MW Petroleum Corporation (“MW”).<sup>89</sup> Thereafter, Amoco sold all of the corporate stock in MW to Apache Corporation.<sup>90</sup>

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83. *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 534–35 (Tex. App. 2008).

84. The Louisiana Supreme Court has held that a right of first refusal applied to a judicial sale. *Price v. Town of Ruston*, 132 So. 653, 656 (La. 1931).

85. See, e.g., Harry M. Reasoner, *Preferential Purchase Rights in Oil and Gas Instruments*, 46 TEX. L. REV. 57 (1967); Harlan Abright, *Preferential Right Provisions and Their Applicability to Oil and Gas Instruments*, 32 SW. L.J. 803 (1978); Jeffrey J. Scott, *Restrictions on Alienation Applied to Oil and Gas Transactions*, 31 ROCKY MTN. MIN. L. INST. 15-1 (1985); John English, *Dealing with Third Parties*, 43 ANN. INST. ON MIN. L. 169 (1996); Terry I. Cross, *The Ties that Bind: Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties*, 5 TEX. WESLEYAN L. REV. 93 (1999); Aimee L. Williams, *Restrictions on Assignment – Consent to Assign, Preferential Right to Purchase and Maintenance of Uniform Interest Provisions*, 49 ANN. INST. ON MIN. L. 224 (2002); John R. Cooney, *Recent Developments Concerning Joint Operating Agreements—Preferential Rights and Exculpatory Clauses*, 55 INST. ON OIL & GAS L. 11-1 (2004); Gerald F. Slattery, Jr., *Understanding Area of Mutual Interest, Preferential Rights and Maintenance of Uniform Interest Provisions in Joint Operating Agreements*, 56 ANN. INST. ON MIN. L. 323 (2009); Fred R. Pletcher & Anthony A. Zoobkoff, *ROFR Madness! Rights of First Refusal in Mining and Oil & Gas Transactions*, 56 ROCKY MTN. MIN. L. INST. 4-1 (2010); Robert K. Wise et al., *First-Refusal Rights Under Texas Law*, 62 BAYLOR L. REV. 433 (2010); Rick Strange & Thomas Fähring, *Rights of First Refusal and Package Oil and Gas Transactions*, 53 S. TEX. L. REV. 29 (2011); Sergesketter, *supra* note 76.

86. 673 So. 2d 668 (La. Ct. App. 1996).

87. *Id.* at 670.

88. *Id.* at 671.

89. *Id.*

90. *Id.* at 672.

Neither the transfer of the leasehold interest by Amoco to MW nor the sale of the corporate stock in MW by Amoco to Apache were offered to Fina in accordance with the “preferential right to purchase” provision contained in the joint operating agreement.<sup>91</sup> The provision explicitly did not apply to transfers by a corporate party in connection with a merger, consolidation, or reorganization to a parent, subsidiary, or affiliated company.<sup>92</sup>

Fina filed suit, claiming that the transfer of the leasehold interest by Amoco to MW triggered the preferential rights option contained in the operating agreement.<sup>93</sup> Fina admitted that “the sale of some or all of the corporate stock of Amoco, while Amoco owned the lease interests, would *not* have triggered the preferential rights and operator selection clauses.”<sup>94</sup> According to the court, the “question then becomes why should the sale of MW stock, while MW held the lease interests, engender a different result?”<sup>95</sup>

Both parties filed motions for summary judgment, agreeing that no genuine issues of material fact remained.<sup>96</sup> As stated by the court, the “issue was whether, as a matter of law, the sale of stock of MW, the holder of the lease interests, triggered the preferential rights operator selection clauses.”<sup>97</sup> The court held as follows:

The transfer of the lease interests to MW was admittedly a valid transfer. The sale of MW stock was not a sale or transfer of the lease interests. MW still holds the lease interests. Thus, no transfer of the lease interests occurred. Without a transfer of the lease interests, the provisions of the various JOAs are not triggered. How or whether MW can validly transfer the lease interests under the JOAs is not the question before this court.<sup>98</sup>

A creative attempt to circumvent the right of first refusal by characterizing a proposed transaction as a merger, rather than a sale, was unsuccessful in one case not involving oil and gas properties.<sup>99</sup> In *McCarthy v. Osborn*, the plaintiff owned corporate stock subject to a restriction on transfer, requiring

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91. *Id.*

92. *Id.* at 671.

93. *Id.* at 672.

94. *Id.* (emphasis in original).

95. *Id.*

96. *Id.* 670.

97. *Id.*

98. *Id.* at 676.

99. *McCarthy v. Osborn*, 65 So. 2d 776 (La. 1953).

that the shares “offered for sale” first be offered to the shareholders.<sup>100</sup> As the court noted:

According to the petition, the stockholders and the Board of Directors first attempted to sell the stock and assets of the Osborn Life Insurance Company. They abandoned their intention to sell when the plaintiff opposed it and offered to purchase the stock of the corporation which she had a perfect right to do under the provisions of the charter and stock certificates heretofore set out. The allegations of the petition are to the effect that the so-called merger is nothing more than a sale. In other words, a sale disguised as a merger to eliminate the plaintiff's rights.<sup>101</sup>

The trial court sustained an objection of no cause of action,<sup>102</sup> but the Supreme Court reversed, holding, as follows:

We have carefully examined the petition and have arrived at the conclusion that the facts alleged are sufficient to show that by the manipulation of the Board of Directors and stockholders that the plaintiff was defrauded of her rights and prevented from having a proprietary interest in the so-called merged or new corporation.<sup>103</sup>

An attempt to circumvent the right of first refusal by characterizing a transfer as a *dation en paiement*, rather than a sale, was disallowed in another case<sup>104</sup> in which the court explained its disallowance of the scheme:

Because the *dation en paiement* transfers ownership and has the same effect as an ordinary sale, drawing a meaningless distinction between a sale and a *dation en paiement* in the context of this contract would allow the Optimist Club to circumvent its obligation simply on the basis of semantics. The object of the February 20, 1974 contract was to give Mr. Gorum the right of first refusal to the property in the event the Optimist Club decided to divest itself of ownership. We find that an interpretation that allows the Optimist Club to divest itself of ownership through a

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100. *Id.* at 777.

101. *Id.* at 778.

102. *Id.* at 776.

103. *Id.* at 778.

104. *Gorum v. Optimist Club of Glenmora*, 771 So. 2d 690 (La. Ct. App. 2000).

*dation en paiement* without providing Mr. Gorum with a right of first refusal results in an absurd and unintended consequence.<sup>105</sup>

Although the “pref right” provision in many operating agreements requires that the right holder be provided “full information concerning the proposed sale,” the courts tend to require “reasonable” information sufficient to provide “information considered material to the right holders’ ability to exercise the preferential right on the same terms and conditions as the bona fide purchaser.”<sup>106</sup>

A holder of a “pref right” who is not notified does not thereby lose its rights.<sup>107</sup> Rather, the purchaser of an asset burdened by a preferential right to purchase acquires the asset subject to the holder’s rights.<sup>108</sup> Notice must be given to the right holder, who has a reasonable time to elect or decline to purchase the interest.<sup>109</sup>

### C. Other Associated Agreements

It is customary to enter other types of arrangements in anticipation of the sale of the producing oil and gas assets. These agreements are innominate contracts that are intended to facilitate the transaction contemplated by the PSA.

#### 1. Confidentiality Agreements

Parties often enter into a confidentiality and non-disclosure agreement to protect certain non-public information from disclosure in the event the transaction does not close. Typically, this form of agreement is the first to be executed in anticipation of the ultimate execution of a PSA.

An agreement of this type would obligate the purchaser to strictly maintain the confidentiality of, and agree to not disclose, the seller’s information of a private, sensitive nature, such as financial information, reserve reports, and other information that is not generally available to the public. A confidentiality agreement facilitates the conduct of due diligence by the purchaser and thus balances the legitimate interests of both the seller and the purchaser. The agreement is typically unilateral, obligating

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105. *Id.* at 695.

106. *See, e.g.*, *Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd.*, 225 S.W.3d 577, 590 (Tex. App. 2005).

107. *See* *McMillan v. Dooley*, 144 S.W.3d 159, 174 (Tex. App. 2004).

108. *Id.*

109. *Id.*

the purchaser to keep confidential information obtained in a review of seller's records.

Generally, the scope of the seller's information sought to be kept confidential is all information of the seller, particularly analyses, reports, studies, etc. By the same token, common exclusions from the scope of confidentiality include information that is: (a) not disclosed in writing or reduced to writing and so marked with an appropriate confidentiality legend within 30 days of disclosure; (b) already in the purchaser's possession at the time of the disclosure; (c) part of the public domain—or later becomes part of the public domain—through no fault of the purchaser; (d) received from a third party having no obligations of confidentiality to the seller; (e) independently developed by the purchaser without using the confidential information; or (f) required by law or regulation to be disclosed.

Additionally, the purchaser may still provide information that is subject to confidentiality and non-disclosure to its counsel, accountants, or bankers, but strictly for purposes of the transaction being considered. The careful seller might seek to impose a "need to know" limitation on those to whom the data may be permissibly shared.

Once the sale is consummated, and the seller has received the consideration for the conveyed assets, the seller is generally no longer concerned with the manner in which the purchaser will utilize this information, unless its scope also encompasses assets retained, but not sold, by the seller. If the transaction is not consummated, the agreement will typically require the purchaser to return all information or destroy it and certify to the seller that it has been destroyed.

Closely associated with the contractual arrangement that requires confidentiality of certain information is a question of whether certain data would constitute a "trade secret" to be regulated under the Louisiana Uniform Trade Secrets Act.<sup>110</sup>

## 2. *Term Sheets*

A "term sheet" is less an agreement or a contract than a roadmap to a more formal agreement. Particularly in a larger, sophisticated transaction, parties deem it appropriate to make sure that, at the nascent stage of discussions and negotiations, both parties are "on the same page" and "heading in the same direction." Thus, a "term sheet" is often prepared to

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110. LA. REV. STAT. ANN. § 51:1431 to :1439 (2003 & Supp. 2016); *see also* John Anthony Chavez, *More Priceless than Gold: Trade Secrets in the Oil and Gas Industry*, 46 ANN. INST. ON MIN. L. 1 (1999).



set forth the salient or material features of the anticipated transaction, including terms, conditions and considerations, sometimes merely in the form of “bullet points.” The execution of a “term sheet” serves as a guide to the lawyer preparing a draft of a “letter of intent,” or PSA.

### 3. *Letters of Intent*

Once parties reach a preliminary understanding pertinent to the sale of the properties, perhaps—but not necessarily—reduced to a “term sheet,” entering into a Letter of Intent (“LOI”) is common.<sup>111</sup> Generally, this is a basic document that sets forth in greater detail the salient features of the transaction and is intended to constitute a framework to lead the parties to the confection of a more formal agreement. If the parties intend for the LOI to merely be a more formalized document than the “term sheet” and do not wish to be bound until a more formalized document is signed, that intent should be made expressly.<sup>112</sup>

Indeed, Louisiana Civil Code article 1947 instructs that, “[w]hen, in the absence of a legal requirement, the parties have contemplated a certain form, it is presumed that they do not intend to be bound until the contract is executed in that form.”<sup>113</sup> For example, parties were not bound to a LOI that stated, “[o]bviously, neither of us will be bound until a contract is executed by both parties.”<sup>114</sup>

Nevertheless, depending on the language utilized, the court might find a sufficient “meeting of the minds” to enforce such an agreement, notwithstanding that the parties had called it “preliminary.” For example, in *Chevron U.S.A., Inc. v. Martin Exploration Co.*,<sup>115</sup> the Louisiana Supreme Court noted that the use of the word *preliminary* “does not preclude the agreement from being final until later agreements are reached or from being the only agreement in the event that no other agreements are confectioned.”<sup>116</sup>

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111. This type of agreement is sometimes called a “memorandum of understanding,” or “MOU.”

112. *Breaux Bros. Constr. Co. v. Associated Contractors*, 77 So. 2d 17, 20 (La. 1954) (“*It is elementary in our law, that where the negotiations contemplate and provide that there shall be a contract in writing, neither party is bound until the writing is perfected and signed.*” (citing *Fredericks v. Fasnacht*, 30 La. Ann. 117 (1878) (emphasis in original))).

113. LA. CIV. CODE art. 1947 (2015).

114. *Spillway Invs., L.L.C. v. Pilot Travel Ctrs. LLC*, No. Civ.A.04-2451, 2005 WL 517498, at \*5 (E.D. La. Feb. 22, 2005).

115. 447 So. 2d 469 (La. 1984). In the interest of full disclosure, the Author of this Article represented a defendant in this suit.

116. *Id.* at 472.

Further, the court found that the reference to a document “finalizing the points listed above” did not evince an intent to be bound only upon the execution of a later instrument.<sup>117</sup> Nor did an allusion to future “negotiations” render the “preliminary” agreement non-binding.<sup>118</sup> To the contrary, the Supreme Court held that the document was binding, as that interpretation most accurately reflected the intentions of the parties.<sup>119</sup>

In *Coe v. Chesapeake Exploration*, a case involving the anticipated purchase and sale of producing properties,<sup>120</sup> Chesapeake entered into an agreement with Peak to acquire “deep rights” in the Haynesville Shale for “the hefty sum of \$15,000 per acre.”<sup>121</sup> The parties entered an agreement in July 2008, entitled “Offer to Purchase.”<sup>122</sup> The court recounted how the controversy arose: “When the price of natural gas plummeted several months later, Chesapeake refused to honor its commitment.”<sup>123</sup> Peak filed suit to enforce the agreement.<sup>124</sup>

Chesapeake made two main arguments. First, “Chesapeake insisted the July Agreement was simply an agreement to negotiate, or LOI, and not binding. It claimed the agreement did not meet the requirements of the Texas statute of frauds and was too indefinite to be enforced.”<sup>125</sup> The court rejected this defense, finding that “the property description contained in the July Agreement achieves the same degree of ‘reasonable certainty’ found in other ‘recital of ownership’ cases,” such that the court could “conclude that the Agreement contains an adequate nucleus of description under the statute of frauds.”<sup>126</sup>

Another argument by Chesapeake was “that the July Agreement is too indefinite to be enforced. Specifically, [Chesapeake] claim[ed] that the parties did not intend to bind themselves by signing the letter and that the agreement lacked essential terms.”<sup>127</sup> This defense also failed, with the court finding that the “July Agreement was sufficiently definite to be

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117. *Id.*

118. *Id.*

119. *Id.*

120. *Coe v. Chesapeake Exploration, L.L.C.*, 695 F.3d 311 (5th Cir. 2012) (applying Texas law).

121. *Id.* at 314.

122. *Id.*

123. *Id.*

124. *Id.* at 315.

125. *Id.*

126. *Id.* at 319.

127. *Id.* at 320.

enforced.”<sup>128</sup> The court affirmed an award for the plaintiffs of nearly \$20 million.<sup>129</sup>

An LOI might be hybrid in that, although the writing might not be intended to be binding, some provisions within the LOI should be expressly declared to be binding. Examples of these binding provisions in an otherwise non-binding writing include provisions dealing with confidentiality or non-disclosure, governing law, and the exclusivity of the LOI. These important components of the parties’ understanding, even in an otherwise non-binding LOI, are meaningless if not made binding and enforceable.<sup>130</sup> Thus, an LOI seems to be non-binding, and no party can have any liability thereunder to the other party.

In one significant case,<sup>131</sup> however, the parties signed letters of intent and a confidentiality agreement in contemplation of a relationship to construct a crude oil pipeline from Oklahoma to Texas.<sup>132</sup> Despite the numerous explicit statements negating the existence of any enforceable relationship, the court deemed the parties’ written agreements to be sufficiently ambiguous that a jury had to determine if the parties intended to be bound.<sup>133</sup> Finding, despite the rather express repudiation of such a relationship, that a partnership had been formed, the jury awarded Energy Partners damages in the amount of \$319 million.<sup>134</sup> Thus, the parties’ numerous, explicit disavowals were not sufficient to overcome the subsequent conduct of the parties, particularly statements made to third parties.<sup>135</sup>

#### 4. Access or Boarding Agreements

Depending on the character of the properties involved, the purchaser or its consultants may need to have access to properties of the seller to inspect such properties in association with the conduct of due diligence.

Particularly in connection with marine operations, or other high-risk structural environments, the seller will insist that the purchaser execute an access or boarding agreement. This agreement will authorize, under

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128. *Id.* at 322.

129. *Id.* at 314.

130. Self-evidently, parties who desire confidentiality intend that such non-disclosure covenants be binding and enforceable, even if the LOI is not intended to manifest a binding agreement.

131. *Energy Transfer Partners, L.P., v. Enter. Prods. Partners, L.P.*, No. DC 1112667, 2014 WL 10120268, at \*1 (Tex. Dist. July 29, 2014).

132. *See id.*

133. *See id.*

134. *See id.*

135. *See id.*

conditions stipulated therein, the purchaser and its consultants to enter the property and conduct inspection or investigatory activities.

Typically, the access will be limited to specified times with advance notice and accompanied by the seller's designated representatives. The purchaser will typically not be allowed to conduct intrusive, invasive, or destructive inspections that alter or damage the property being inspected. The purchaser will also be obligated to release the seller from liability in advance and to indemnify the seller from any liability caused or damages incurred by the purchaser or its investigatory team.

### *5. Transition Agreements*

Typically, three critical dates are involved in a transaction concerning the purchase and sale of producing oil and gas properties. The first is the date of execution of the PSA, principally relevant in that it commences certain periods of time, such as the due diligence period and the title defect date by which the purchaser must assert any title, environmental, or other defects discovered by its due diligence. Usually, the failure on the part of the purchaser to timely assert a title defect results in a waiver of that deficiency in title to the asset.

The effective date of the transaction is the next significant date. The effective date is often some date—typically, 7:00 A.M. on the first date of a calendar month—which precedes the date of execution of the agreement.

The final date of note is the date of closing. Although stipulated in the PSA, this date is often deferred to a later date if necessary to conclude due diligence or to obtain necessary consents or waivers from third parties. When the transaction is consummated at the closing date, the purchaser rarely assumes the management and administration of the conveyed assets immediately. Because of the complexities of the purchase and sale of producing properties, parties might execute a “transition agreement,” which envisions that, for some period of time after the closing date, the seller will continue to operate the property until the purchaser is in a position to assume those responsibilities of ownership. Generally, this agreement includes an undertaking by the seller to continue to produce oil and gas, market the production, to receive the proceeds, to pay severance taxes and royalties, and to pay vendors for their services or equipment, all for the account of the purchaser.

If the assets are complex and numerous, perhaps located in multiple parishes or states, an agreement of this sort allows a seamless and uninterrupted transition of ownership that permits the purchaser a period of time to familiarize itself with the assets and to set up its records so that it might assume administrative duties.

From the viewpoint of the seller, the agreement allows it to maintain the value of the assets, for the benefit of both parties, by avoiding any mistakes or missteps because the seller will continue to operate in the same manner as it has historically done. The purchaser benefits from a transition agreement as it is afforded the time to add requisite systems, personnel, or equipment to manage these new assets and also to obtain necessary regulatory approvals or permits.

If the property being sold and acquired is subject to an existing operating agreement with third parties—other than the seller and the purchaser—it is necessary to review that agreement to ensure that no violation arises by reason of the sale. As a consequence of the sale, the seller no longer owns an interest in the Contract Area and is deemed to forfeit the right to operate the properties for the joint account.<sup>136</sup>

Additionally, the COPAS attached to the JOA should be reviewed to ensure that costs being charged in this interim arrangement are consistent with the strictures of that agreement, including the competitiveness of rates charged for services.<sup>137</sup> If the seller has served as operator, it might have master service agreements in place with a variety of contractors or service providers. Some period of time is necessary to transition those agreements to the new operator.

The transition from seller to the purchaser is facilitated by periodic meetings between representatives of the parties to coordinate activities in the interim period of time, until the purchaser is ready to fully assume responsibility for operational activities of the assets that it acquires at the closing. Typically, under the regime of the transition agreement, the seller is required to conduct its activities in a good and workmanlike manner and as a reasonably prudent operator. Because of the hazardous nature of oil and gas activities, it should be clarified and affirmed that the seller's employees remain the employees of the seller and not of the purchaser for any purpose. The purchaser customarily indemnifies the seller from liability, except for the willful misconduct or gross negligence of the seller

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136. A common provision in the model form operating agreement states that, “[i]f Operator . . . no longer owns an interest hereunder in the Contract Area, . . . , Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor.” AAPL Model Form Operating Agreement, Form 610 (1982).

137. COPAS is the acronym for the Council of Petroleum Accountants Societies. *Mack Energy Co. v. Expert Oil & Gas, LLC*, 159 So. 3d 437, 439 (La. 2015). COPAS procedures are a form of accounting procedure, which is the standard in the oil and gas industry. *See generally* J. David Heaney, *The Joint Operating Agreement, the AFE and COPAS: What They Fail to Provide*, 29 ROCKY MTN. MIN. L. INST. 772 (1983); John E. Jolly, *The COPAS Accounting Procedures Demystified*, 34 ROCKY MTN. MIN. L. INST. 21-1 (1988).

or its employees. The parties should confirm that the insurance maintained by the parties covers the activities and interests of each party.

If, for any reason, the purchaser is unable to operate the property after the closing, the parties might also enter into a contract operating agreement pursuant to which the seller or some other entity will operate the property for the account and benefit of the purchaser. The contract operator is typically compensated on a per diem, weekly, or monthly basis for its services.

#### *D. Agreements of Sale*

Although important, the PSA is not the document that announces to the world the transfer of the mineral leases from the seller to the purchaser. The PSA is not customarily recorded, and does not need to be. Rather, that important document provides and anticipates that the parties will evidence the consummation of the transaction by executing and recording an assignment. Although immaterial to its import,<sup>138</sup> the name of the recorded document might be “Conveyance, Assignment and Bill of Sale” or simply “Assignment.”

This recorded document often makes reference to the PSA and sometimes restates certain provisions that the parties deem the most significant. Generally, these incorporated clauses pertain to allocation or assumption of responsibility, agreements as to indemnity, and other provisions. Although the indemnity obligation is valid between the parties, regardless of whether the obligation is reflected of record, the beneficiary of the indemnity often finds a sense of comfort in providing notice to third persons of this particular arrangement.

The Assignment, being the “contract of sale,” is regulated by a series of Louisiana Civil Code provisions. For one, the Assignment must contain the essential elements of a sale: the thing, the price, and the consent of the parties with respect to the thing and the price.<sup>139</sup> The “thing” is the mineral lease(s) that is contemplated by the PSA, as well as all other “things” being sold, such as contracts, wells, equipment, records, etc. The “price” is the purchase price specified in the PSA, which might be revised or adjusted in accordance with its terms and provisions. Finally, the “consent” is self-

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138. See *Howard Trucking Co. v. Stassi*, 474 So. 2d 955, 960 (La. Ct. App. 1985) (“It is well-established that we are not bound by the label placed on a written agreement or the subjective intent of the contracting parties, but must look to the substance of the transaction in determining rights and obligations.”), *aff’d*, 485 So. 2d 915 (La. 1986).

139. LA. CIV. CODE art. 2439 (2015).

evidently manifested by the execution of both the PSA, and the resulting Assignment.

Secondly, the Assignment must be in proper form. Because the object of the sale is immovable property, the Assignment “must be made by authentic act or by act under private signature, except as provided in Article 1839.”<sup>140</sup> The “sale” is obviously embodied in a written agreement executed by the seller (the “assignor”) and the purchaser (the “assignee”) and is virtually never executed by way of an authentic act unless in the extremely rare case the parties employ a credit sale.<sup>141</sup> Notably, article 2440 makes an exception to the writing requirement “as provided in Article 1839.”<sup>142</sup> That cited article provides, in relevant part, that a “transfer of immovable property” may be made orally and “is valid between the parties,” provided that “the property has been actually delivered and the transferor recognizes the transfer when interrogated on oath.”<sup>143</sup>

Thirdly, the Assignment transfers ownership “between the parties as soon as there is agreement on the thing and the price is fixed, even though the thing sold is not yet delivered nor the price paid.”<sup>144</sup> Although a literal reading of this provision suggests that the PSA itself constitutes a vehicle by which ownership is transferred between the parties, one must recognize that the PSA—even though it constitutes an “agreement on the thing,” and “fixes the price”—contains numerous conditions and requirements that clearly negate any notion that it is intended to be the “agreement of sale” sufficient to transfer ownership.

Fourthly, the Assignment “includes all accessories intended for its use in accordance with the law of property.”<sup>145</sup> This provision is important to the assignee, as it ensures that the assignee acquires those “accessories intended for [the] use” of the mineral leases. Still, the exhibits attached to the PSA and which are virtually always attached to the assignment

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140. *Id.* art. 2440.

141. Although a credit sale need not be executed by way of an authentic act to validly convey the assets, it would be necessary to utilize that form if the seller (mortgagor) in a credit sale wishes to employ executory process to enforce the reserved mortgage, and vendor’s privilege. *See generally* Patrick S. Ottinger, *Enforcement of Real Mortgages by Executory Process*, 51 LA. L. REV. 87 (1990).

142. LA. CIV. CODE art. 2440.

143. *Id.* art. 1839; *see also* Harter v. Harter, 127 So. 3d 5, 12 (La. Ct. App. 2013) (upholding an oral transfer of a working interest based upon the corporation’s internal records and the conduct of the parties, and noting that, “since [defendant’s] actions evidence an actual delivery of the interests and he subsequently recognized such delivery under oath, the requirements for a valid oral transfer found in Article 1839 have been met”).

144. LA. CIV. CODE art. 2456.

145. *Id.* art. 2461.

typically will comprehensively describe and identify the contracts, wells, equipment, records, etc., that support and enhance the operation of the mineral leases conveyed.

Finally, the Assignment must fix the price “in a sum either certain or determinable through a method agreed by them” and contemplate that the price, which may not be “out of all proportion with the value of the thing sold,” will actually be paid.<sup>146</sup> The quality or sufficiency of the price being paid by the assignee for the mineral leases and other properties is rarely, if ever, an issue. The purchase price is robustly negotiated, and it is subject to adjustment depending on conditions specified in the PSA. Purely as a matter of custom and practice, parties do not usually set forth in the Assignment the precise amount paid by the purchaser for the assets. Usually, it is merely stipulated that “\$100 and OVC” or some similar, nominal amount was paid to and received by the assignor.<sup>147</sup> The failure to state the precise amount of the purchase price actually paid is not problematic, however, for “[a]n obligation may be valid even though its cause is not expressed.”<sup>148</sup> Further, “[w]hen the expression of a cause in a contractual obligation is untrue, the obligation is still effective if a valid cause can be shown.”<sup>149</sup> Indeed, one Louisiana court has held that “parol evidence is clearly admissible between the parties to show the real consideration of any contract.”<sup>150</sup> Regardless, the “sale of a mineral right is not subject to rescission for lesion beyond moiety.”<sup>151</sup>

#### IV. CUSTOMARY FEATURES OF A PURCHASE AND SALE AGREEMENT

There are two alternative approaches to the acquisition of producing properties, perhaps with variations. Arguably the more prevalent approach involves the negotiation and ultimate execution of a PSA, which by its express terms allows the purchaser a period of time after such execution to conduct due diligence. The transaction will then proceed to a closing, unless due diligence reveals a sufficient monetary level of title or other defects that might afford the purchaser the option to “walk away” and to not close on the acquisition.

Another approach is to “sign and close,” meaning that the PSA affords no post-execution period of time within which to conduct due diligence.

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146. *Id.* art. 2464.

147. “OVC” means “other valuable consideration.”

148. *Id.* art. 1969.

149. *Id.* art. 1970.

150. *Great Sweet Grass Oils Co. v. Kroy-Am. Oils, Inc.*, 129 So. 2d 591, 594 (La. Ct. App. 1961).

151. *See supra* Part II.C; LA. REV. STAT. ANN. § 31:17 (2000).



Rather, with the due diligence being conducted *before* the execution of the PSA, the agreement merely obligates the purchaser to close the trade, pay the purchase price, and purchase the assets. In this scenario, the purchaser could also merely acquire the properties by way of a final assignment, which actually conveys the assets, dispensing with a PSA. However, there is often still a need for certain understandings between the parties, such as indemnities, assumptions of obligations, transitional terms, etc., that the parties might prefer to not place on record. If that is the case, the PSA will embody those terms that are not spread across the public records, with the recorded assignment effectuating the transfer of the assets from the seller to the purchaser.<sup>152</sup>

In the former approach—involving the negotiation and execution of a PSA followed by a period of time to conduct due diligence and take other actions in anticipation of a closing—the PSA contains extensive procedures and provisions to effectuate the transaction contemplated. Although the length and scope of the PSA can vary greatly, depending on the nature of the properties and the relative sophistication of the contracting parties, the agreement will customarily contain an array of provisions to address the transaction.

Limitations of space preclude a detailed, extensive consideration of all of the types of provisions that might be included and are often encountered. Rather, a few of the more consequential provisions will be considered in this Part. In addition, an enumeration of provisions that might be contained in a more sophisticated, comprehensively constructed purchase and sale agreement of producing properties is found in the Appendix to this Article.<sup>153</sup>

#### *A. Definitions*

The more sophisticated form of PSA will include a section containing a detailed definition of terms. In turn, these terms are employed throughout the PSA for consistency and ease of interpretation. For example, an important definition that permeates the agreement is the term “Effective Date,” or “Effective Time,” of the agreement.<sup>154</sup> The fixing of the Effective

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152. See LA. CIV. CODE art. 2442 (“The parties to an act of sale or promise of sale of immovable property are bound from the time the act is made, but such an act is not effective against third parties until it is filed for registry according to the laws of registry.”).

153. See *infra* Appendix I.

154. The “Effective Date” or “Time” is usually the first day of some calendar month, at 7:00 A.M. Although now perhaps more a matter of lore than reality, the custom of the industry has historically been that production is gauged at that time of day.

Date promotes several important purposes, not the least of which is setting the anticipated demarcation point of ownership between the seller and the purchaser for purposes of cost responsibility and revenue entitlement. A number of other terms are important to define in the PSA, including perhaps most importantly the “Property” that is the object of the sale, and the “Purchase Price.”

### *B. Property and Purchase Price*

Customarily, the initial portion of the PSA is devoted to an explanation of the essential provisions of the proposed sale. The essential provisions of the PSA, as with any sale under Louisiana Civil Code article 2439, involve the “thing” that constitutes the object of the contract of sale and the “price” to be paid by the vendee.<sup>155</sup> As a result, the PSA will contain clauses that provide both for a statement of the assets to be sold and for a statement of the preliminary purchase price.

#### *1. Identification of Assets to be Sold and to be Excluded*

The heart of the agreement is the list of the assets to be conveyed. Utilizing defined terms to encompass the categories and types of property subject to the PSA and attached exhibits for greater specificity, the agreement generally contemplates the following types of property as being subject to the PSA: (a) mineral leases, including amendments, ratifications or corrections; (b) other operational contracts, such as farm-in or farm-out agreements, voluntary unit agreements, disposal agreements, and pipeline agreements; (c) servitudes, surface leases, rights-of-way, and licenses associated with, or dedicated to the use or operation of, the mineral leases; (d) hydrocarbons produced subsequent to the Effective Date of the PSA; (e) wells and equipment located on the lands covered by the mineral leases; and (f) books and records owned by the seller in connection with the assets to be conveyed. This is simply an enumeration of the essential assets that the parties typically contemplate to convey. Other particular properties can be listed in accordance with the parties’ agreement.

Of equal importance to an identification of the assets that are being conveyed is a statement of those assets of the seller that are *not* subject to the transaction and that the seller will retain. These are usually called “Excluded Assets” and might be defined as including the following types of property, by way of illustration only: (a) all audit rights and other rights and choses in action arising, occurring, or existing in favor of seller before

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155. LA. CIV. CODE art. 2439; *see also id.* art. 2623 (“A contract to sell must set forth the thing and the price . . .”).

the Effective Date, or arising out of the operation of or production from the Oil and Gas Properties before the Effective Date, which include, but are not limited to, any and all contract rights, claims, receivables, revenues, recoupment rights, recovery rights, accounting adjustments, mispayments, erroneous payments or other claims of any nature in favor of seller and relating to and accruing any time period before the Effective Date; (b) any accounts receivable or payable accruing before the Effective Date; (c) all corporate, partnership, financial, tax and legal records of seller, other than title; (d) all hydrocarbon production from or attributable to the Properties with respect to all periods before the Effective Date, and all proceeds attributable thereto; (e) all claims for refunds of costs, taxes or expenses borne by seller attributable to the period before the Effective Date; (f) all deposits, cash, checks, funds and accounts receivable or received attributable to seller's interests in the Properties with respect to any period of time before the Effective Date; (g) all computer or communications equipment and software or intellectual property—including tapes, data and program documentation, and all tangible manifestations and technical information relating thereto and the GEPX Accounting System—owned, licensed, or used by seller, except that purchaser shall be entitled to receive data related to accounting with third parties as specified in the agreement; (h) any logo, service mark, copyright, trade name, or trademark of or associated with seller or any affiliate of seller or any business of seller or an affiliate; (i) all interpreted geological and geophysical data that cannot be transferred without the consent of or payment to any third party; (j) all vehicles and vessels; and (k) any documents withheld or not transferred pursuant to the agreement, including any files, records, information, or data to the extent that seller is prevented from disclosing or transferring such property to purchaser.

The import and effect of the “Excluded Assets” provision of a PSA was at issue in a case arising out of Texas.<sup>156</sup> That case involved oil and gas assets located on the Outer Continental Shelf, situated off of the coast of California.<sup>157</sup> Plains successfully sued the Federal government after it repudiated certain leases, with Plains recovering more than \$83 million.<sup>158</sup>

In this case, the court explained the factual underpinning of the suit, as follows:

At issue is the proper construction of a 1996 purchase and sale agreement in which Torch Energy Advisors Inc. sold its leasehold

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156. Plains Exploration & Prod. Co. v. Torch Energy Advisors Inc., No. 13–0597, 2015 WL 3653330, at \*5 (Tex. June 12, 2015).

157. *Id.* at \*1–2.

158. *Id.* at \*4.

interests in undeveloped oil and gas fields located outside territorial waters off the coast of California. Certain tangible and intangible interests were excluded from the conveyance on terms described in the purchase and sale agreement. More than a decade later, a federal court determined that the federal government had repudiated the mineral leases because a statute enacted several years before the conveyance had later been applied in a manner that precluded development of the leasehold interests. As a result, the purchaser's successor in interest, Plains Exploration & Production Company, was awarded restitution of the lease-bonus payments Torch's predecessor had paid to secure the leases. Although not a party to the litigation, Torch claimed an ownership interest in roughly half the judgment based on the terms of the excluded-assets provision in the 1996 agreement. When Plains declined to pay, Torch sued, alleging various contract, tort, and equitable theories of recovery.<sup>159</sup>

Torch contended that it was entitled to share in Plains' recovery because the monies so obtained allegedly came within the ambit of an "Excluded Asset" retained by Torch in the 1996 PSA.<sup>160</sup> The clause on which Torch relied read, as follows:

§ 1.2. Excluded Assets. As used herein, "*Excluded Assets*" means . . . (b) all claims and causes of action of [Torch] (i) arising from acts, omissions or events, or damage to or destruction of property, occurring prior to the Effective Date, (ii) arising under or with respect to any of the Contracts that are attributable to periods of time prior to the Effective Date (including claims for adjustments or refunds); . . . (g) all proceeds, income or revenues (and any security or other deposits made) attributable to (i) the Properties for any period prior to the Effective Date, or (ii) any Excluded Assets . . .<sup>161</sup>

Torch argued that "these provisions reserve any future benefit of monies spent or actions taken pre-conveyance with respect to the leases, while the contract otherwise conveyed all future production benefits to Plains."<sup>162</sup> Rejecting this contention, the court held as follows:

Viewing the contract as reserving, in perpetuity, any claim, cause of action, or resulting judgment that could ever be asserted under

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159. *Id.* at \*1.

160. *Id.* at \*5.

161. *Id.* at \*6 (quoting the Agreement to Purchase and Sale between the parties to the lawsuit).

162. *Id.* at \*9.

laws in existence at the time of the conveyance is not a reasonable construction of the excluded-assets provision.

Because the proceeds of the *Amber* judgment are neither attributable to nor arising from or with respect to pre-conveyance events, they are not excluded assets within the meaning of sections 1.2(b)(i), 1.2(b)(ii), and 1.2(g) of the 1996 PSA. Torch therefore has no claim to any portion of the judgment.<sup>163</sup>

The “take-away” from this case is that great care must be taken in defining terms employed in the PSA and in understanding the import and interplay between these terms.

### 2. Preliminary Purchase Price

The parties will stipulate the base, or preliminary, purchase price to be paid by the purchaser for the assets being sold by the seller. This statement of monetary consideration is necessarily preliminary because it is subject to adjustment, either upward or downward, depending on a variety of reasons, all specified in the parties’ agreement.<sup>164</sup> Starting with the Preliminary Purchase Price, the process that the PSA envisions should conclude with a fixed and determined Final Purchase Price, thus satisfying the codal requirement that the “price must be fixed by the parties in a sum either certain or determinable through a method agreed by them.”<sup>165</sup>

### 3. Deposit

Depending on a variety of issues—not the least of which is the magnitude of the transaction in terms of the amount of the purchase price, as well the prior history between the parties—the PSA may require that the purchaser post a deposit, perhaps 10% of the purchase price, to ensure the purchaser’s performance under the agreement. The disposition of the deposit should be addressed in the PSA, both as to the circumstance when the closing occurs or does not occur.

The concept of earnest money has been held applicable to a transaction involving oil and gas leases.<sup>166</sup> The default nature of a deposit under Louisiana law, however, has changed since the repeal of Louisiana Civil

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163. *Id.* at \*11.

164. For a discussion of the circumstances giving rise to an adjustment of the purchase price, see *supra* Part IV.B.4.

165. LA. CIV. CODE art. 2464 (2015).

166. See *Baird v. United States*, 3 F. Supp. 947, 949 (W.D. La. 1933), *aff’d*, 65 F.2d 911 (5th Cir. 1933).

Code article 2463,<sup>167</sup> which provided: “[I]f the promise to sell has been made with the giving of earnest, each of the contracting parties is at liberty to recede from the promise; to wit: he who has given the earnest, by forfeiting it; and he who has received it, by returning the double.”<sup>168</sup> Under this law, money given as a deposit in connection with an agreement to purchase and sell property was presumed to constitute earnest money unless the parties negated the agreement being regarded as such.<sup>169</sup> This treatment of a deposit in connection with a contract to sell necessitated an express statement that the money would not be “deemed” as earnest money.<sup>170</sup>

Effective January 1, 1995, the provision concerning “earnest money” is governed by Louisiana Civil Code article 2624, which establishes the opposite presumption regarding deposits: “A sum given by the buyer to the seller in connection with a contract to sell is regarded to be a deposit on account of the price, unless the parties have expressly provided otherwise.”<sup>171</sup> Thus, under the new law, parties must stipulate that a sum given to the seller is earnest money, in which case “either party may recede from the contract, but the buyer who chooses to recede must forfeit the earnest money, and the seller who so chooses must return the earnest money plus an equal amount.”<sup>172</sup> Further, article 2624 makes clear that “[w]hen earnest money has been given and a party fails to perform for reasons other than a fortuitous event, that party will be regarded as receding from the contract.”<sup>173</sup>

#### 4. Purchase Price Adjustments

It is also important to consider the conduct of “due diligence,” a procedure or activity that affords the purchaser the opportunity to satisfy itself that the seller validly owns what it states that it owns and that the purchaser will be acquiring those assets that it intends to acquire for the price to which the parties have agreed. If the conduct of due diligence identifies defects in the title of the Assets, the environmental condition of the property, or otherwise as contemplated by the PSA, the agreement typically affords an opportunity to either terminate the agreement or adjust the purchase price.

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167. Act No. 841, 1993 La. Acts 2239.

168. LA. CIV. CODE art. 2463 (1992).

169. *Smith v. Hussey*, 43 So. 902, 904–05 (La. 1907).

170. *See id.*

171. LA. CIV. CODE art. 2624 (2015).

172. *Id.*

173. *Id.*

One published report elucidates on the issue of the frequency of a Purchase Price Adjustment resulting from the conduct of due diligence as follows:

The November 2014 study from the David Eccles School of Business at The University of Utah — *Title Clean-Up Analysis* (by K. Bown, M. Dixon, J. Ingebritson and K. Rodriguez) — analyzed approximately 5,600 leases and deeds from two fairly large lease deals with dozens of predecessors. The four-person research team expected the data to show that the net gains and losses in acreage from title defects would even out. What they discovered instead is that title defects are two times more likely to result in a net *loss* than in a net gain in acreage. In their analysis of 145 additional public transactions, the team revealed a lack of organization, transparency, and accountability across the industry. Of those 145 transactions, 48 listed both the original announced price and the price at closing. Of those 48, one-half (23) had a different price at closing.<sup>174</sup>

Many PSAs utilize a defined term “Defensible Title.” As that term is not one typically used in the civil law, parties contracting in Louisiana should change “Defensible Title” to “Merchantable Title,” or even “Marketable Title.”<sup>175</sup> This defined term embodies the standard against which the quality and sufficiency of the title of the seller is to be evaluated,

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174. Mikal E. Belicove, *Taking the Guesswork Out of Oil and Gas Lease Contracts*, HART ENERGY (Feb. 12, 2015, 11:01 AM), <http://www.oilandgasinvestor.com/blog/taking-guesswork-out-oil-and-gas-lease-contracts-782881>.

175. “Property has a merchantable title when it can be readily sold or mortgaged in the ordinary course of business by reasonable persons familiar with the facts and questions involved.” *Young v. Stevens*, 209 So. 2d 25, 27 (La. 1967); *accord Parker v. Machen*, 567 So. 2d 739, 743 (La. Ct. App. 1990). Title is unmerchantable when it is suggestive of litigation. *See Hardtner v. Dixie Oil Co.*, 113 So. 357, 358–59 (La. 1927). “The word ‘merchantable’ implies something less than a perfect title and permits of defects which are not reasonably liable to result in assault.” *Langford Land Co. v. Dietzgen Corp.*, 352 So. 2d 386, 388 (La. Ct. App. 1977) (quoting *Roberts v. Medlock*, 148 So. 474, 476 (La. Ct. App. 1933)); *see also Schaub v. O’Quin*, 38 So. 2d 63, 65 (La. 1948) (“The purchaser . . . is entitled to receive a complete, valid, unclouded title; he cannot be compelled to accept a title burdened with a claim having a substantial basis and, therefore, which is suggestive of serious future litigation; his agreement provided for the purchase only of the property, not the property plus a probable law suit.”).

particularly as to the quantification of the interests as represented by the seller in the PSA.

If the conduct of title due diligence reveals any discrepancy in either the Working Interest (“WI”) or Net Revenue Interest (“NRI”) as represented by the seller, or other insufficiency in title, the question then presented is whether it meets the definition of a “title defect” as articulated in the PSA.<sup>176</sup>

If the due diligence conducted by the purchaser’s team discovers a discrepancy that is in the favor of the seller, in that the calculated WI or NRI is higher than the represented WI or NRI, that is a “title benefit” and is subject to being declared to the seller in the same manner as a title defect. An upward variance in the calculated decimal interest is a “title benefit,” inuring to the benefit of the seller in that it increases its WI or NRI, potentially leading to an increase in the purchase price.

Usually, any downward variance in the calculated decimal interest as found by the due diligence effort, as contrasted with the represented numbers, will meet the definition of “title defect.”<sup>177</sup> Typically, a matter would not be deemed to constitute a title defect if it is covered by the definition of another defined term, such as “Permitted Liens” or “Permitted Encumbrances.”<sup>178</sup> An abbreviated listing of matters residing under the ambit of the term employed in the PSA might include the following:

- (a) defects or irregularities arising out of lack of corporate authorization, or a variation in corporate name, unless Purchaser provides affirmative evidence that such corporate action was not authorized and results in another person’s superior claim of title to the relevant Property;

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176. WI is the undivided interest owned by a person or company in and to a mineral lease. Costs and expenses of operation of a well are borne by the owners of the working interest in and to the mineral lease on which the well is drilled, or in the unit in which such well is located, in accordance with their respective working interest. NRI is the proportionate part of revenue attributable to the WI, after considering and excluded the royalty interest held by others.

177. As will be seen, however, that conclusion does not necessarily mean that the defect is one that can be asserted.

178. Although it is common for a PSA to refer to “Permitted Liens,” properly speaking, Louisiana law does not recognize the institution of “lien.” Rather, in the Bayou State’s civil law, it is denominated as “privilege.” *See* Succession of Benjamin, 2 So. 187, 188 (La. 1887) (“The term ‘lien’ is not used in our law as significative of any particular sort of incumbrance. It is a legal term used generally to signify any incumbrance on property, but, we may say, usually employed in connection with privileges, and rarely with mortgages.”).



- (b) defects or irregularities that have been cured or remedied by applicable statutes of limitation or statutes for prescription;
- (c) defects or irregularities in the chain of title consisting of the failure to recite marital status in documents or omissions of heirship proceedings;
- (d) defects or irregularities in title that, for a period of five years or more, have not delayed or prevented Seller [or Seller's predecessor, if owned by Seller less than five years] from receiving its Net Revenue Interest share of the proceeds of production, or caused it to bear a share of expenses and costs greater than its Working Interest share from any unit or well;
- (e) defects or irregularities resulting from or related to probate proceedings, or the lack thereof, which defects or irregularities have been outstanding for five years or more;
- (f) conventional rights of reassignment normally activated by an intent to abandon or release a lease and requiring notice to the holders of such rights, and any other defect or irregularity as would normally be waived by persons engaged in the oil and gas business when purchasing producing properties;
- (g) lessor's royalties, non-participating royalties, overriding royalties, reversionary interests, and similar burdens upon, measured by, or payable out of production if the net cumulative effect of such burdens does not operate to reduce the Net Revenue Interest of Seller in any well or unit to an amount less than the Net Revenue Interest set forth on Schedule I for such well or unit, and does not obligate Seller to bear a Working Interest for such well or unit in any amount greater than the Working Interest set forth on Schedule I for such well or unit unless the Net Revenue Interest for such well or unit is greater than the Net Revenue Interest set forth on Schedule I in the same proportion as any increase in such Working Interest;<sup>179</sup>
- (h) all applicable laws, and rights reserved to or vested in any governmental authority (i) to control or regulate any Property in any manner; (ii) by the terms of any right, power, franchise, grant, license, or permit, or by any provision of law, to terminate such right, power, franchise, grant, license, or permit; to purchase, condemn, expropriate, or recapture; or to designate a purchaser of

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179. It is customary to attach to the PSA a schedule or exhibit that identifies the leases or wells being sold and setting forth the WI and NRI for each identified property. If the represented WI or NRI is subject to potential change (increase or decrease) because of any circumstance (e.g., a future "payout" event), that is also reflected in the interest of disclosure and understanding.

any Property; (iii) to use such Property in a manner that does not materially impair the use of such Property for the purposes for which it is currently owned and operated; and (iv) to enforce any obligations or duties affecting any Property to any governmental authority, with respect to any franchise, grant, license, or permit;

(i) rights of a common owner of any interest in rights-of-way or easements currently held by Seller and such common owner as tenants in common or through common ownership;

(j) easements, conditions, covenants, restrictions, servitudes, permits, rights-of-way, surface leases and other rights in the Properties, for the purpose of surface operations, roads, alleys, highways, railways, pipelines, transmission lines, transportation lines, distribution lines, power lines, telephone lines, removal of timber, grazing, logging operations, canals, ditches, reservoirs, and other like purposes, or for the joint or common use of real estate, rights-of-way, facilities, and equipment that do not materially impair the use, ownership, or operation of the Properties as currently owned and operated;

(k) zoning and planning ordinances and municipal regulations;

(l) any encumbrance affecting the Properties that is discharged by Seller at or prior to Closing; and

(m) the Leases, the Basic Documents, and all other liens, privileges, charges, encumbrances, contracts, agreements, instruments, obligations, defects, and irregularities affecting the Properties that individually or in the aggregate are not such as to materially interfere with the ownership, operation, or use of any of the Properties as currently owned and operated, and do not reduce the Net Revenue Interest of Seller in any well or unit to an amount less than the Net Revenue Interest set forth on Schedule I for such well or unit and do not obligate Seller to bear a Working Interest for such well or unit in any amount greater than the Working Interest set forth on Schedule I for such well or unit unless the Net Revenue Interest for such Property is greater than the Net Revenue Interest set forth on Schedule I in the same proportion as any increase in such Working Interest.

The purchaser should carefully scrutinize the listing of “Permitted Liens” as proposed by the seller and endeavor to eliminate those matters that represent a risk that the purchaser is unwilling to assume.

Conversely, it is in the seller’s best interest to “load up” the enumerated matters so that the purchaser cannot assert these circumstances as a title defect at a later date. Indeed, if the seller is aware of a particular matter that is arguably a title defect, but the issue has been lingering for a

significant period of time without complaint, the seller will deem it reasonable to let that sleeping dog lie, and avoid any possibility of awakening that sleeping dog. By listing it as a “Permitted Lien,” the seller is afforded the opportunity to bring the matter to the attention of the purchaser before the PSA is signed, with the understanding that the matter should be left alone.

Other defects not involving a variance in the calculated WI or NRI could also be asserted as a title defect, if they meet the contractual definition of that term. Examples would be a mineral lease affecting community property that has been signed by one spouse only; subject to a superior mortgage, which has not been subordinated; executed by a succession representative for which court authority was not perfectly obtained; for which an assignment from a prior record owner to the current seller is unavailable, and so on. These illustrations are title defects and, unless such defects are cured, they will negatively affect the calculation of the WI and NRI. As a result, full realization of the WI and NRI as represented by the seller in the PSA cannot be achieved.

The end product of the title due diligence effort is to declare or assert these defects on or before the “Title Defect Notice Date,” as specified in the PSA. This date is typically a reasonable number of days before the closing date to afford a period of time for the seller to evaluate the asserted title defect and either undertake to cure the defect or otherwise resolve it as specified in the PSA.

The title defect notice typically requires certain specified information, such as the following: (a) a description of the Asserted Defect and the wells and/or units listed on Schedule I to which it relates, and all supporting documentation reasonably necessary to fully describe the basis for the Defect or, if the supporting documentation is contained in Seller’s Files, sufficient information to enable Seller to expeditiously locate such supporting documentation; (b) for each applicable well or unit, the size of any variance from WI or NRI, which does or could result from such Asserted Defect; and (c) the amount by which Purchaser would propose to adjust the Base Purchase Price, which amount shall not exceed the Allocated Amount of the Properties affected by such Asserted Defect.

Despite that a number of title defects have been identified as meeting the definition of “title defect,” the agreement might specify either a “floor” or a “ceiling” that must first be met before these defects can be validly asserted. It might be provided that, for an identified defect to be considered, it must meet a certain monetary threshold, typically called a “basket.” For example, the agreement might provide that a defect having a value of less than \$50,000—or any other threshold amount to which the parties might agree—is not to be considered. At the same time, the PSA

may contemplate that otherwise eligible title defects will not be taken into account unless and until, in the aggregate, the defects equal or exceed a certain “threshold,” often stated as a percentage of the total preliminary purchase price. An example of such a clause might read:

Notwithstanding the provisions set forth above, a Title Defect or Title Benefit shall not result in an adjustment in the Preliminary Purchase Price unless the aggregate net value of all Title Defects and Title Benefits with respect to the Interests claimed by the parties is greater than five percent (5%) of the Preliminary Purchase Price (the “Threshold Amount”). In such event, the Preliminary Purchase Price on the Closing shall be adjusted by the aggregate net value of all Title Defects or Title Benefits.

Clarity can also be brought to this issue by a clause that might read, as follows:

Notwithstanding anything herein to the contrary, the Base Purchase Price shall not be reduced pursuant to this Section, unless and until the aggregate of all such reductions exceeds five percent (5%) of the Base Purchase Price (which amount shall be a threshold, not a deductible).

Care should be taken that the seller has no opportunity to “double dip,” by effectuating a *de minimis* basket or threshold as well as a deductible. By the same token, the defect amount asserted by a purchaser should be regulated by a clause that provides that “any allowable defect amount shall be determined and calculated without duplication of any cost or loss asserted by way of any other allowable defect amount pertaining to the same property.” Otherwise, one party or the other would be availing a contractual right on a duplicative basis, resulting in an inequitable adjustment upward or downward on the purchase price.

Upon timely receipt of notice of title defects meeting the threshold, if any, the seller typically has a few options. Generally, at the election of the seller, the PSA might provide that the seller can cure the defect, postpone the closing, proceed to close while holding back the asset subject to the asserted defect with a consequential reduction of the purchase price, or terminate the agreement.

A downward adjustment to the purchase price—inuring to the benefit of the purchaser—might arise for a variety of reasons. The amount of any title defects, environmental defects, or the elimination of an asset by reason of the exercise by a third party of a “pref right,” are the most typical examples. A downward adjustment can also result from gas imbalances for which the purchaser will have responsibility in the future. The purchase

price might also be reduced by other circumstances to which the parties agree in writing.

On the other hand, the purchase price might be increased by reason of a title benefit discovered during the conduct of title due diligence. Also, an upward adjustment might be caused by capital expenditures incurred by the seller, but pertaining to activities conducted after the effective date of the sale, and, thus, for which the purchaser would be responsible.

An adjustment, either upward or downward, might arise by reason of the value of production revenues received by one party or the other, but attributable to production accruing to the other party in reference to the effective date of the transaction. A case in point can be found on reports that Chesapeake filed with the Securities and Exchange Commission, which are available for public viewing.<sup>180</sup> There, a disclosure is made as to a PSA pertaining to the sale by Chesapeake to Southwestern Energy of assets in the Marcellus and Utica Formations in Wetzel County, West Virginia.<sup>181</sup> The PSA reflected a purchase price greater than \$5 million.<sup>182</sup> Seemingly, a dispute arose as to the sufficiency or adequacy of title, and resulted in a settlement of such matters in the amount of \$400 billion by way of a reduction of the purchase price.<sup>183</sup>

### C. Due Diligence

A critical aspect of the purchase and sale of producing properties is the conduct of due diligence. Long gone are the days—if they ever existed—when *caveat emptor* was the prevailing model.<sup>184</sup> Due diligence refers to the conduct of such investigation and inspection of the assets as is necessary or appropriate to allow the purchaser to become fully familiar with the quality and sufficiency of the assets involved, and as to the range of obligations inherent therein. The term “due diligence” is actually derived from a provision in the Securities Act of 1933, which afforded a defense to broker-dealers who were charged with inadequate or insufficient disclosure to potential purchasers of offered securities.<sup>185</sup> This important topic has

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180. See Chesapeake Energy Corporation Annual Report [SEC Form 10-K] (2014), available at <https://www.nyse.com/quote/XNYS:CHK/sec>.

181. *Id.*

182. *Id.*

183. *Id.*

184. “*Caveat emptor*” means “let the buyer beware” in Latin. It connotes that the seller is assuming no responsibility for the quality or sufficiency of its title, leaving the matter to the buyer to satisfy itself with respect to such matters. See BLACK’S LAW DICTIONARY 252 (9th ed. 2009).

185. See 15 U.S.C. § 77k (2014).

been the subject of excellent articles presented at the Institute on Mineral Law.<sup>186</sup>

### *1. Purpose and Objective*

The seller—and the purchaser, for that matter—in a PSA customarily make certain representations and warranties, called by way of short hand “reps and warranties.” Among these “reps and warranties” might be a number of representations to the effect that the seller owns, perhaps subject only to “Permitted Liens” or “Permitted Encumbrances,”<sup>187</sup> the working interest and net revenue interest set forth on a schedule to the PSA. The question might be asked as to why these explicit representations are not sufficient, and why, in view thereof, it is necessary to conduct due diligence.

There are a number of reasons why the purchaser should not rely solely on the seller’s “reps and warranties.” First, unless a robust due diligence is undertaken, the purchaser is essentially taking the assets at “face value,” on a *caveat emptor* or “as is” basis, without the knowledge of particular defects or deficiencies that if known in advance of the execution of a PSA, would lead to a refinement or expansion of “reps and warranties” that the purchaser might seek to obtain from the seller. Next, the “reps and warranties” of the seller are often qualified by a knowledge qualifier—“to the best of seller’s knowledge”—or are limited, by provisions in the PSA, as to the manner of enforcement of a claim for breach of warranty. Some forms of PSA provide: “None of the representations and warranties contained in this Agreement, or in any certificate delivered at Closing shall survive the Closing and the delivery of the Conveyance.” In lieu of this limitation, the PSA might provide that the “reps and warranties” only survive for a stated period of time, even as short as six months. Additionally, accepting the seller’s “reps and warranties” as a sole basis to be comfortable as to title affords no opportunity to adjust the purchase price based upon any discrepancy in the WI and NRI numbers represented by the seller. Finally, by purchasing the properties without the conduct of a robust due diligence, a purchaser should always be concerned about the future ability of the seller to respond to an indemnity demand based upon a title discrepancy discovered post-closing, particularly many years later. These reasons and others establish

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186. See, e.g., Janin H. Jones & Mark E. Robinson, *Due Diligence for the 90s from the Land and Legal Perspectives*, 42 ANN. INST. ON MIN. L. 1 (1995); Aaron G. Carlson, *Due Diligence in Oil and Gas Acquisitions*, 54 ANN. INST. ON MIN. L. 83 (2007).

187. See *supra* Part IV.B.4.

that the conduct of a comprehensive due diligence effort is the prudent course of action for the purchaser.

The due diligence that is typically conducted is performed by employees, as well as outside landmen, abstracters, and other consultants. Once the due diligence team is assembled, the next issue is to determine the manner in which access to the seller's records will be allowed. It is typical that, among other covenants or undertakings made by the seller, it will covenant to provide access to the business records for purposes of the conduct by the purchaser of due diligence. Such access also is regulated by notions of reasonableness, during business hours, and perhaps with a stated amount of advance notice.

The seller might elect to place all relevant documents and files in a "data room," so as to control the review process, and thereby avoid a "stranger" from "roaming" through its files. More currently, the practice is to scan all records, and provide access in a "lock box" or virtual space, via an assigned password. The "old fashioned" way is to permit the purchaser's team of landmen and other consultants to visit the office of the seller and examine the relevant documents.

Due diligence basically falls into three principal categories: title, environmental, and regulatory. Other investigatory efforts residing under the moniker of due diligence would pertain to an examination of financial, litigation, contractual, and insurance matters.

## 2. Title Due Diligence

In a sense, the prudence of conducting title due diligence is reminiscent of that sage observation uttered by Hedley Lamarr—played by Harvey Korman—in the classic movie, *Blazing Saddles*.<sup>188</sup> This villain planned to buy up land and resell it to the railroad.<sup>189</sup> "Unfortunately," he says, "there is one thing standing between me and that property—the rightful owners."<sup>190</sup> Due diligence has as its purpose, if anything, a determination or confirmation that the seller is in fact the "rightful owner" of the assets the PSA embraces.

To this end, the seller typically will attach to the PSA a schedule that lists the assets to be conveyed, and sets forth a representation by the seller of the working interest and net revenue interest associated with each distinct property. The purchaser then allocates a portion of the total purchase price to the properties described on the schedule of assets. Although the purchaser typically undertakes to allocate the initial values,

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188. *BLAZING SADDLES* (Warner Bros. 1974).

189. *Id.*

190. *Id.*

carefully scrutinizing the values so assigned is in the interest of both parties, as these allocated values have the potential to either increase or decrease the purchase price in some instances.

Indeed, the allocation of the total purchase price serves two fundamental purposes. First, in the event that a party holding a preferential right to purchase as to a particular asset should exercise such right, the value allocated to that property would fix the price to be paid by the “pref right” holder, and the purchase price would be accordingly reduced. Next, in the event of a title defect or title benefit, the purchase price would be adjusted downward—in the event of a title defect—or upward—in the case of a title benefit—based on the formula in the PSA.

Typically, the WI and NRI, which are set forth on a schedule and constitute an express representation by the seller, relate to an identified well or unit. Generally, the represented numbers are not broken out on a lease-by-lease basis. This manner of attribution causes issues of translation in that, by definition, working interest and net revenue are associated with distinct mineral leases and, in the case of unit production, the numbers are then aggregated to the unit or the well to which such mineral leases relate.

This means that, as a minimum, the due diligence team needs a copy of all mineral leases and amendments, as well as any instruments creating additional burdens on production affecting the subject leases, such as the unit survey plat, and information from the Office of Conservation confirming that the unit well is in fact perforated within the unitized interval.

Additionally, the due diligence team would like to gain comfort from reviewing division orders, if they exist, and royalty checks to show the manner in which the royalties have been historically distributed by the operator. With respect to the WI being conveyed, the team would want to view JIB statements<sup>191</sup> to confirm that the operator consistently recognized the cost-bearing responsibility of the seller.

Also inherent in the title due diligence is the issue of “lease maintenance,” that is, confirming that the mineral leases have, in fact, been maintained in force and effect to a current date. This necessitates a review of cancelled checks representing the payment of delay rentals, and royalties. These lease payments constitute “rent,”<sup>192</sup> and the failure to pay such payments, or the improper payment thereof, would either result in the termination of the lease—with respect to the nonpayment of delay

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191. A “JIB statement” is a “joint interest billing statement,” which reflects the percentage or decimal responsibility of each WI owner for costs in the unit or lease in question.

192. LA. REV. STAT. ANN. §§ 31:123 (2000).



rentals<sup>193</sup>—or the potential for lease dissolution or double royalties as damages (as pertains to the nonpayment of royalties).<sup>194</sup> This type of historic information is not always available, particularly if the assets are represented by mineral leases that are many years old.

Typically, the PSA includes a lease schedule, which lists all mineral leases subject to the transaction. If the schedule indicates that any one or more leases are limited as to subsurface depth—say, the lease is shown to cover only “shallow rights,” or “deep rights” under the leased premises—the title due diligence must at a minimum determine that the lease only covers those depths. The purchaser must check whether seller is proposing to convey the entirety of the interest covered by the mineral lease, or if some third person owns—or perhaps the seller itself intends to reserve—the non-described subsurface depth. If the mineral lease is determined to cover all subsurface depth, but only the “shallow rights” or the “deep rights” are being conveyed, inquiry should be made into the possibility that the mineral lease has been or will be divided—a critical issue that directly implicates lease maintenance.<sup>195</sup>

The due diligence team will also review the seller’s lease files to discern if any demand by the lessor to correct an alleged breach of the mineral leases has been or is currently pending, and how any such demand or claim of breach has been resolved. It would not be usual that there is ample time to obtain full abstracts of title covering title to the lands affected by the mineral leases that are the subject to the transaction. Typically, the due diligence team will attempt to identify and obtain any existing title opinions and bring them current with respect to the interest being conveyed. This is accomplished by sending abstracters or brokers to the pertinent courthouses to examine the public records from the closing date of any existing and available title opinions or abstracts to a current date.

In that regard, one does not ordinarily “look behind” the title opinion, nor spend any time or money in bringing them current with respect to an interest not being purchased. The constraints of time usually disallow any opportunity to verify all findings in the title opinion. Since the operator has relied upon the findings of such opinions, presumably without

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193. *Id.* at § 31:133.

194. *Id.* at §§ 31:137 to :142.

195. *See generally* Ottinger, *What’s in a Name?*, *supra* note 53. As a general proposition, “lease division,” when it is presented, means that activities that would maintain in force and effect one of the mineral leases, “would not result in the perpetuation of the second lease because, in essence, they are now separate and distinct leases, albeit each being regulated under the same contractual terms as specified in the original lease document.” *Id.* at 309.

complaint, relying on the findings of the opinion as expressed is commercially reasonable. Reviewing each unsatisfied title opinion requirement is necessary, however, to evaluate whether curative actions are appropriate.<sup>196</sup>

With this information, the lawyer will examine the documentation provided, in an attempt to verify the accuracy of the WI and NRI numbers represented by the seller. If there is a discrepancy, it is to be identified, and the lawyer should attempt to frame curative requirements, that is, those actions that, if taken, will cure or rectify the discrepancy. If the discrepancy cannot be clarified, it might give rise to a purchase price adjustment or some other mode of resolution.

As critical as a review of the conveyance records is to the important purpose of verifying that the interests owned by the seller have not been alienated, examining the mortgage records to confirm that the seller's properties are not subject to any mortgage or privilege is equally as important. Clearly, if that is the case, the purchaser will not want to acquire the interests and then be subject to losing them at a judicial sale.

Purely as a practical matter, if a property has been producing for a great period of time without complaint, and if nothing is revealed in an examination of the seller's files that suggests a precarious or tenuous relationship with the lessor, some comfort might be gained from such fact under the well-known theory of the "sleeping dog."

Beyond the issue of title—as important as that is—the due diligence team will endeavor to identify any restrictions on assignability or preferential rights to purchase. The ability on the part of the seller to convey the assets without restriction is directly contingent on a confirmation that no such restrictions exist. If these restrictions exist, abiding by the relevant provision, and then either seeking to obtain the requisite consent or approval or a waiver, is necessary.<sup>197</sup>

A seller can be determined to have perfect title to the assets that are subject to the PSA, but that determination is of little comfort if the seller is not a validly created legal entity, lacking the capacity to own or convey title.<sup>198</sup> Thus, a subset of the title due diligence is confirmation that the seller is a validly created legal entity in good standing with its state of incorporation or organization, and of the state in which the assets are located.

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196. Further comfort might be gained by the mere passage of time, in reliance on principles of acquisitive prescription.

197. See LA. REV. STAT. ANN. §§ 31:126 to :128 (2000).

198. See LA. CIV. CODE art. 479 (2015).

### 3. *Environmental Due Diligence*

In recent years, the topic of the environmental condition of the property has become an issue of paramount interest to the purchaser. This is particularly so if the agreement envisions that the purchaser must undertake remediation efforts or indemnify the seller in reference to the condition of the lands covered by leases.

#### *a. Scope*

Since the decision of the Louisiana Supreme Court in *Corbello v. Iowa Production*,<sup>199</sup> and the spate of litigation resulting therefrom, it is imperative that the purchaser conduct at least a cursory inspection of the property, as well as the records of the seller, to ascertain that the environmental condition of the property is not such as to result in a lawsuit seeking damages for failure to remediate the land.<sup>200</sup>

A site visit by engineers and consultants is essential to clearly understand the nature, placement, configuration, and condition of equipment located on the property. This important effort constitutes an environmental site assessment (“ESA”), and these studies are categorized in “phases.”<sup>201</sup>

More specifically, a Phase I ESA is the more superficial, and does not typically entail actual sampling of soil, air, or groundwater.<sup>202</sup> The more intrusive ESA is the Phase II ESA, which actually involves the collection and analysis of soil and groundwater samples.<sup>203</sup> The Environmental Protection Agency has promulgated rules and regulations pertaining to these investigations, matters that, although of critical importance, are beyond the scope of this paper.<sup>204</sup>

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199. 850 So. 2d 686 (La. 2003), *reh’g granted in part*, 850 So. 2d 714 (La. 2003); *see also* *Corbello v. Iowa Prod.*, 851 So. 2d 1253 (La. Ct. App. 2003) (judgment rendered on remand).

200. *See* Susan G. Zachos & Brenda L. Clayton, *State of the Art of Negotiating Environmental Issues in Energy Industry Purchase and Sale Agreements*, 55 INST. ON OIL & GAS L. 13-1 (2004).

201. *See* Charles P. Efflandt, *When the Tail Wags the Dog: Environmental Considerations and Strategies in Business Acquisitions, Sales and Merger Transactions*, 39 WASHBURN L.J. 28, 43–44 (1999).

202. *Id.* at 43.

203. *Id.* at 44.

204. *See, e.g.*, 40 C.F.R. 302–307 (2003).

*b. Regulatory Requirement*

If any of these types of investigation are conducted, the parties must be mindful of Louisiana Revised Statutes section 30:29.1, which provides as follows:

If the owner or operator of any oilfield site or exploration and production (E&P) site covered by the provisions of R.S. 30:29 performs any environmental testing on land owned by another person, results of such environmental testing shall be provided to the owner or owners of the land within ten days from receipt of such results by the owner or operator, regardless of whether or not suit has been filed by the owner or owners of the land. The operator or owner or owners of land or anyone acting on their behalf who perform any environmental testing on land that is an oilfield or exploration and production (E&P) site shall provide the results of such testing to the department within ten days of receipt.<sup>205</sup>

A variety of consulting firms might be contracted for this purpose. The seller probably will insist that the purchaser assume all responsibilities to remediate the property, and plug and abandon the wells. In contrast, the purchaser will want to know the potential scope of this responsibility in financial terms as best as they can be ascertained or estimated.

*c. Site-Specific Trust Agreements*

Additionally, major issues between parties to a sale of producing properties include the environmental condition of the property, the potential for future regulatory action by the Louisiana Office of Conservation relative to the remediation of the property, and the plugging and abandonment of inactive wells.<sup>206</sup> As a general proposition, the Commissioner of Conservation will seek enforcement against the current operator of record.<sup>207</sup> It has long been the policy of the Office of Conservation, however, to seek enforcement against a prior owner or

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205. LA. REV. STAT. ANN. § 30:29.1 (2007).

206. LA. ADMIN. CODE tit. 43, pt. XIX, § 101 (2011). For an illustration of the problems that can be encountered as a consequence of a failure to properly plug and abandon a well, see *Magnolia Coal Terminal Co. v. Phillips Oil Co.*, 576 So. 2d 475 (La. 1991).

207. See J. Patrick Batchelor, Comm'r of Conservation, La. Dep't of Natural Res., Memorandum, Enforcement Policy—Abandoned Wells and Pits (July 24, 1990).

operator in the event the current operator cannot be located or is unable to perform the necessary remedial activities.<sup>208</sup>

To be sure, the sale and assignment of the assets of which the field is composed is no impediment to the Commissioner seeking performance from a prior operator.<sup>209</sup> Parties to the transfer of an oilfield site<sup>210</sup> have the opportunity to establish a site-specific trust account (“SSTA”) “for the purpose of providing a source of funds for site restoration of that oilfield site at such time in the future when restoration of that oilfield is required.”<sup>211</sup> To establish a site-specific trust account, a contractor approved by the Oilfield Site Restoration Commission must conduct an oilfield site restoration assessment.<sup>212</sup> The parties must fund the account in accordance with a funding schedule that the parties proposed and the Commission approved.<sup>213</sup>

Once the SSTA is approved and the account is fully funded, the party transferring the oilfield site “shall not thereafter be held liable by the state for any site restoration costs or actions associated with the transferred oilfield site.”<sup>214</sup> Instead, “[t]he party acquiring the oilfield site shall thereafter be the responsible party.”<sup>215</sup>

Although the establishment of a site-specific trust account might immunize the seller from regulatory responsibility, that in no manner affects the right of the lessor to enforce private contractual rights against a former owner. Indeed, the Louisiana Mineral Code unequivocally instructs that “[a]n assignor or sublessor is not relieved of his obligations or liabilities under a mineral lease unless the lessor has discharged him expressly and in writing.”<sup>216</sup>

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208. See *Yuma Petroleum Co. v. Thompson*, 731 So. 2d 190, 195 (La. 1999).

209. See *id.*

210. LA. REV. STAT. ANN. § 30:29(I)(5) (2007) (“‘Oilfield site’ or ‘exploration and production (E&P) site’ means any location or any portion thereof on which oil or gas exploration, development, or production activities have occurred, including wells, equipment, tanks, flow lines or impoundments used for the purposes of the drilling, workover, production, primary separation, disposal, transportation or storage of E&P wastes, crude oil and natural gas processing, transportation or storage of a common production stream of crude oil, natural gas, coal seam natural gas, or geothermal energy prior to a custody transfer or a sales point. In general, this definition would apply to all exploration and production operations located on the same lease, unit or field.”).

211. *Id.* § 30:88(A).

212. *Id.* § 30:88(B).

213. *Id.* § 30:88(C).

214. *Id.* § 30:88(F).

215. *Id.*

216. LA. REV. STAT. ANN. § 31:129 (2000).

#### 4. Regulatory Due Diligence

The seller might convey to the purchaser perfect title to the assets subject to the PSA. Further, there may be no significant environmental exposure disclosed by the purchaser's environmental due diligence. But this is of little comfort if the purchaser cannot operate the assets by reason of deficiencies in the suite of necessary permits and licenses that the operator is, by law, required to hold to lawfully operate the properties. Thus, the purchaser should investigate the status of all permits, licenses and other permissions that are required by law, whether federal, state, or local.

##### a. Administrative

A range of governmental authorities—federal, state, or local—might require some sort of permission to hold or operate oil and gas properties. At the risk of failing to identify a particular agency or authority, one should be mindful of certain commonly encountered issues. If any of the mineral leases constituting the assets to be sold is one granted by the State of Louisiana, through the State Mineral and Energy Board, it should be confirmed that the assignor, as well as the anticipated assignee, is properly registered as a “prospective leaseholder.”<sup>217</sup> If the assets include leases on the Outer Continental Shelf, under the jurisdiction of the Bureau of Ocean Energy Management, the purchaser should confirm that the seller—and, eventually, the purchaser—is duly qualified to own or hold offshore federal leases as required by applicable law.<sup>218</sup> Most critically, due diligence should verify that all wells are properly and currently authorized by proper permits that the Louisiana Office of Conservation issued, and that no compliance orders are outstanding or threatened with respect to any such wells.

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217. LA. REV. STAT. ANN. §§ 30:127A, :128A (Supp. 2015).

218. See 43 U.S.C. § 1337 (2012); 30 C.F.R. § 256.35 (2011) (“Mineral leases issued pursuant to section 8 of the Act may be held only by: (1) Citizens and nationals of the United States, (2) aliens lawfully admitted for permanent residence in the United States as defined in 8 U.S.C. 1101(a)(20); (3) private, public or municipal corporations organized under the laws of the United States or of any State or of the District of Columbia or territory thereof, or (4) associations of such citizens, nationals, resident aliens, or private, public, or municipal corporations, States, or political subdivisions of States.”).

*b. Regulatory*

If the pertinent assets are geographically located such that they are subject to the requirements of the State and Local Coastal Resources Management Act of 1978,<sup>219</sup> additional inquiries are applicable. Mineral activities within the Coastal Zone, “including exploration for, and production of, oil, gas, and other minerals, all dredge and fill uses associated therewith, and all other associated uses,” constitute a “use of state concern” and therefore are subject to the requirements of that regulatory scheme.<sup>220</sup> The precise jurisdictional description of the Coastal Zone is set forth by statute<sup>221</sup> and on a map or chart available for public inspection in the offices of the coastal management program of the Department of Natural Resources and each local government in the Coastal Zone.<sup>222</sup> But the Coastal Zone jurisdiction may generally be considered as all lands lying south of the Intracoastal Canal on the Western side of the state and south of Interstate Highway 10 on the Eastern side of the state.<sup>223</sup>

No person may commence a use of state or local concern without first applying for and receiving a coastal use permit.<sup>224</sup> The regulations pertaining to such applications and permits are quite extensive and have been the subject of litigation.<sup>225</sup> Efforts should be made to ascertain that all necessary permits are in hand relative to any activity in the Coastal Zone.

A variety of permits are necessary for certain types of equipment that might be used in connection with the exploration and production (“E&P”) activities of the seller, for which it is necessary to obtain permits for their operation. This includes—by way of example only—a permit that establishes effluent limitations, prohibitions, reporting requirements, and other requirements for discharges associated with oil and gas facilities.<sup>226</sup> Additionally a permit is required to operate facilities that emit pollutants into the atmosphere, typically called a “minor source air general permit.”<sup>227</sup> These permits are transferable upon compliance with notice and other requirements by the issuing agency.<sup>228</sup>

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219. LA. REV. STAT. ANN. § 49:214.21 to :214.42 (2012).

220. *Id.* § 49:214.25.

221. *Id.* § 49:214.24C.

222. *Id.* § 49:214.24D.

223. *Id.*

224. *Id.* § 49:214.30A(1).

225. *See, e.g.,* *Pardue v. Stephens*, 558 So. 2d 1149 (La. Ct. App. 1989).

226. LA. ADMIN. CODE tit. 33, pt. III, § 513.A.2 (2007).

227. *Id.*

228. *Id.* pt. I, § 1907.

### *5. Other Areas of Interest in the Conduct of Due Diligence*

Although these categories—title, environmental, and regulatory—are important, other topics should be considered, particularly in a large transaction. These areas pertain to an examination of financial, litigation, contractual, and insurance matters.

#### *a. Financial*

Under the moniker of financial due diligence, one would be concerned with the performance of the producing assets as it relates to the revenue stream to the operator from the production historically obtained over a previous period of time. This entails a determination as to historic “lifting costs,” prices received for the product being produced, existing marketing contracts—particularly the term, price, and any provision for price redetermination—and whether rates being paid under existing service contracts are reasonable and competitive. Additionally, costs of bonds or other forms of financial assurance, placed with a regulatory body or landowner, or prior owner, must also be identified and understood. Tax liabilities for any taxable asset should also be evaluated. The purchaser’s chief financial officer, or other employees concerned with financial matters, possess the critical skills needed to make these assessments.

#### *b. Litigation*

The pendency of any litigation affecting an asset should be determined. Although this topic is often the subject of a specific representation of the seller, the purchaser should “dig deeper” into the topic so as to evaluate the potential that it would be joined to the suit, or whether an adverse judgment would impede purchaser’s right to enjoy the assets that it is purchasing. The purchaser should search the public records,



particularly the mortgage records, to ascertain if a notice of lis pendens has been filed.<sup>229</sup>

The rights of a purchaser to acquire property free and clear of claims asserted in a lawsuit, if no notice of lis pendens has been filed, was recognized in one case,<sup>230</sup> where the court explained:

Inasmuch as the sale to the Majors was recorded in the public records of Catahoula Parish prior to the filing of plaintiffs' suit and Notice of Lis Pendens, none of the matters alleged in plaintiffs' petition could affect the Majors. They are third parties who have relied on the public records. No discussion of the well established principles enunciated in these cases is necessary.<sup>231</sup>

For example, if a pending suit pertains to the title or ownership of, say, a mineral lease, which is covered by the PSA, consideration should be given as to whether the other party to the litigation could exercise the right to redeem the asset under the doctrine of the sale of litigious rights—i.e., rights that are “contested in a suit already filed.”<sup>232</sup> Under Louisiana Civil Code article 2652:

When a litigious right is assigned, the debtor may extinguish his obligation by paying to the assignee the price the assignee paid for the assignment, with interest from the time of the assignment. . . .

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229. Regulations concerning a notice of lis pendens are found in the Louisiana Code of Civil Procedure. LA. CODE CIV. PROC. ANN. art. 3751 (2003) (“The pendency of an action or proceeding in any court, state or federal, in this state affecting the title to, or asserting a mortgage or privilege on, immovable property does not constitute notice to a third person not a party thereto unless a notice of the pendency of the action or proceeding is made, and filed or recorded, as required by Article 3752.”); *id.* art. 3752 (Supp. 2015) (“A. The notice referred to in Article 3751 shall be in writing, signed by the plaintiff, defendant, or other party to the action or proceeding who desires to have the notice recorded, or by a counsel of record for such party showing the name of the persons against whom it is to be effective, the name of the court in which the action or proceeding has been filed, the title, docket number, date of filing, and object thereof, and the description of the property sought to be affected thereby. B. This notice shall be recorded in the mortgage office of the parish where the property to be affected is situated and has effect from the time of the filing for recordation. The notice shall cease to have effect after ten years from the date of its filing for recordation. Nevertheless, if the action or proceeding is still pending, the notice may be reinscribed by refiling the notice. A reinscription of the notice that is filed before the effect of recordation ceases continues that effect for five years from the day the notice is reinscribed.”).

230. *Succession of Wilson v. Wilson*, 446 So. 2d 526 (La. Ct. App. 1984).

231. *Id.* at 529 (citations omitted).

232. *See* LA. CIV. CODE art. 2652 (2015).

Nevertheless, the debtor may not thus extinguish his obligation when the assignment has been made to a co-owner of the assigned right, or to a possessor of the thing subject to the litigious right.<sup>233</sup>

*c. Contractual*

An assessment should be made as to the contracts in place for the administration or operation of the properties in order to understand future or potential cost liability. The purchaser would want to know if any contract would result in the future disruption or reduction of the seller's right to receive proceeds of production. These issues arise in the event that there is a "payout" arrangement being tracked, or future gas balancing responsibilities in the event of a split-stream marketing arrangement.<sup>234</sup>

The importance of determining the existence of any imbalance in gas production was demonstrated by the case of *Petro-Hunt, L.L.C. v. Wapiti Energy, L.L.C.*<sup>235</sup> Petro-Hunt entered into an agreement to sell certain properties to Wapiti.<sup>236</sup> In its PSA, Petro-Hunt represented to the purchaser that it had no knowledge of any production imbalance.<sup>237</sup> The agreement further provided that the seller would deliver to purchaser a proposed final settlement statement within 60 days after closing.<sup>238</sup>

After closing, but before the delivery of the final settlement statement, "Petro-Hunt became aware that its representation and warranty that there were no production imbalances in the relevant interests was not true."<sup>239</sup> It acknowledged this fact in the statement, which it delivered to the

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233. *Id.*

234. "Payout" is the point in time at which the owners of the working interest in and to a well have recovered out of production attributable to their interests, the entirety of the costs and expenses incurred in the drilling, completion, equipping and operating of the well. At that point, it often occurs that a third party is entitled to receive an interest in production, such that the NRI of the working interest owners will be diminished accordingly.

A "split-stream marketing arrangement" is presented when working interest owners are marketing their share of production separate and apart from any other working interest owner. If a particular owner fails to market its share in a particular month, production imbalances occur, a matter discussed in the next case.

235. No. 01-10-01030-CV, 2012 WL 761144 (Tex. App. Mar. 8, 2012).

236. *Id.* at \*1.

237. *Id.* The parties also agreed that "[a]ll representations and warranties set forth in this Agreement . . . shall survive for a period of twelve (12) months following Closing." *Id.*

238. *Id.*

239. *Id.* at \*2.

purchaser.<sup>240</sup> The parties agreed that they did not have sufficient information to resolve this imbalance, and thus, that “[s]ettlement for the gas imbalances will be made as soon as the amounts are known and mechanics of settlement can be agreed upon by the Parties.”<sup>241</sup> The parties settled on all other aspects of the transaction as covered by the final settlement.<sup>242</sup>

Wapiti sought and obtained information from the operator, ExxonMobil, with respect to the gas imbalance, and informed Petro-Hunt that it was owed \$349,730.<sup>243</sup> Petro-Hunt responded that it “refused to pay Wapiti for the gas imbalance.”<sup>244</sup> After filing suit, Wapiti obtained a summary judgment on liability.<sup>245</sup> A trial was held to determine damages.<sup>246</sup> The court awarded Wapiti \$424,811.80 in actual damages and \$318,113 in attorneys’ fees, plus additional fees for the defense of the judgment on appeal.<sup>247</sup>

On appeal, Petro-Hunt argued that the parties’ purchase and sale agreement required the concurrence of the parties on the post-closing amounts: “Without such agreement, under the terms of the [PSA], the post-closing amounts were not due. Petro-Hunt argued that no agreement was possible, because the amount of the imbalance, if any, was not known.”<sup>248</sup> The court rejected this point of error, finding that the evidence supported the existence of the imbalance.<sup>249</sup>

Petro-Hunt next urged that “the trial court improperly calculated damages by valuing the entire imbalance as of the gas value on a single day.”<sup>250</sup> The court rejected this argument, finding that the testimony was “legally sufficient to support the trial court’s determination that the value of the production imbalance should have been based on the value of gas on the closing date.”<sup>251</sup>

The purchaser must also identify any required consents to assign, or other restriction on the free assignability of any particular asset that is the subject of the PSA, specifically as it pertains to mineral leases. By the same token, the existence of any preferential right to purchase must be

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240. *Id.*

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.* at \*1.

246. *Id.*

247. *Id.* at \*3.

248. *Id.* at \*6.

249. *Id.* at \*7.

250. *Id.* at \*8.

251. *Id.* at \*10.

identified and examined. If the seller is relying on agreements with landowners—other than the lessor under a mineral lease—for access to any well site, the seller should verify that all necessary contractual arrangements are in place, in force and effect, not subject to a pending termination, and do not contain unusual terms that would cause a disruption in production or access to the property. Contractual commitments in the form of future drilling obligations under a mineral lease, farm-in agreement, or proposal for the conduct of a subsequent operation under an operating agreement,<sup>252</sup> must be identified and quantified.

This phase of due diligence—an examination of extant contractual arrangements—arguably overlaps with the conduct of title due diligence insofar as it is necessary to review the mineral leases held by the seller. The purpose of examining these critical contracts is to, first and foremost, verify that they have been maintained in force and effect, and, secondly, to identify any onerous or unusual terms. Particularly important is evaluating the possibility that the lease has been “divided” by virtue of a prior partial assignment, either vertical or horizontal—a consideration that is important, but is also beyond the scope of this paper.<sup>253</sup>

#### *d. Insurance*

The cost and coverage that liability insurance affords must be examined, particularly if these matters are required by either contract or regulatory requirement.

#### *D. Representations and Warranties*

The PSA customarily contains certain basic representations of stated fact and express warranties, provided both by the seller and the purchaser. From the viewpoint of the purchaser, the statement of such “reps and warranties,” while important and comforting, does not obviate the necessity to conduct due diligence into the matters discussed above. Many of the representations and warranties might be considered as mundane or routine, such as statements as to the due organization of each party; the authority of the person who serves as signatory for each party; that the execution of transaction documents will not violate any pertinent law or court order, or result in a default under any other agreement; and that the PSA, and other documents, are valid, binding and enforceable. The

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252. See generally Patrick S. Ottinger, *Be Careful What You Ask For: Subsequent Operations Under the Model Form Operating Agreement*, 63 ANN. INST. ON OIL & GAS L. 281 (2012).

253. See Ottinger, *What's in a Name?*, *supra* note 53.

agreement usually provides that such “reps and warranties” are valid and accurate when first stated, and will also be true at closing.

### *1. Of the Seller*

Beyond the basic “reps and warranties” noted above, the seller might make specific statements as to certain matters and confirm that the matters reflected on identified schedules attached to the PSA are true and complete. Examples include the following: inclusion of schedules describing and identifying pending litigation; consents and approvals necessary to be obtained; preferential rights to purchase, which must be respected; that all royalties and other interests in production have been paid; and negating the fact that there are outstanding obligations—such as AFE’s, cash calls, or well proposals—in excess of a stated amount of money, for which purchaser will have responsibility.<sup>254</sup>

### *2. Of the Purchaser*

The seller would expect the purchaser to make an explicit representation that no litigation is pending or threatened which would preclude the consummation of the transaction. Additionally, the seller would be vitally interested in knowing, by way of a representation on the part of the purchaser, that the latter has the funds to purchase the assets, or has arranged financing for that purpose.

Particularly if the seller is unfamiliar with the purchaser, the seller should seek certain representations having as their purpose the disallowance of any opportunity on the part of the purchaser to rescind the sale of the leases as being unregistered securities. Representations of this type include assertions that the purchaser is purchasing the assets “for its own account, and not with the intent to make a distribution in violation of the Securities Act of 1933 as amended (and the rules and regulations

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254. An “AFE” is an Authorization for Expenditure, a document issued by an operator to a non-operator in which an estimate of the costs to drill a well (or conduct some other activity) is set forth, and seeking the approval of the non-operator to participate in the activity described therein, and to pay its share of the estimated costs. A “cash call” is a demand by the operator, pursuant to a provision in the operating agreement, for a non-operator to advance its share of costs anticipated to be incurred in the next calendar month. A “well proposal” is a proposal by a party (who may be a non-operator) to conduct some specified operation, and calling upon all other parties to express their concurrence and agreement to share in costs to be incurred in the operation.

pertaining thereto),” or words to that effect.<sup>255</sup> Another example of representation would be that the purchaser is an experienced oil and gas operator who is “able to evaluate the merits and risks of an investment in the Properties,” and understands the risks associated therewith. Further, that the purchaser “has made its own independent investigation of the Properties to the extent necessary to evaluate the Properties,” could prove to be a useful warranty in that it demonstrates that the purchaser is not an innocent, unknowing, or unsophisticated business person.

One party or the other will often resist a particular representation or warranty upon which the other party insists, unless that warranty is qualified by a “knowledge qualifier.” This may mean, for example, that a matter is stated “to the best knowledge of Seller,” which would mean the actual knowledge of the personnel of the seller.

### *E. Covenants*

Covenant means “a promise of a particularly solemn nature, made in such a manner as to communicate its enduring character and the highest commitment that the promise will be fulfilled.”<sup>256</sup> Thus, a covenant is a promise to do, or not do, something. When made in a PSA, the beneficiary of the covenant is entitled to rely upon the other party’s promise in entering the contractual relationship.

The word “covenant” appears in only five articles of the Civil Code, none of which abide the understanding of the term as used in a purchase and sale agreement.<sup>257</sup> Oil and gas lessees are also familiar with the term as used in reference to the so-called “implied covenants” of the lessee, but even the source article for these important rules is void of that term.<sup>258</sup>

A covenant differs from a representation or warranty, on which the other party is also anticipated to rely, in that the covenant is usually more focused, perhaps less generalized, and is actionable to the extent that it constitutes an explicit undertaking, directed to a particular matter or interest. The PSA customarily contains covenants that precede the closing

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255. See Jack D. Laird, *The Sale of Fractional Interests in Oil, Gas and Mineral Rights—When are They Considered Securities?*, 43 INST. ON OIL & GAS L. & TAX’N 6-1 (1992).

256. 1 THE WOLTERS KLUWER BOUVIER LAW DICTIONARY 281 (Stephen Michael Sheppard ed., 2012).

257. LA. CIV. CODE arts. 102, 103, 3099, 3106, 3180 (2015).

258. LA. REV. STAT. ANN. § 31:122 (2000) (“A mineral lessee is not under a fiduciary obligation to his lessor, but he is bound to perform the contract in good faith and to develop and operate the property leased as a reasonably prudent operator for the mutual benefit of himself and his lessor. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee.”).

(“pre-closing covenants”), and those which endure after the closing occurs (“post-closing covenants”).

### *1. Pre-Closing Covenants*

As a promise by one party to the other, a covenant typically would be stated as “Seller will” do something, or “Seller shall use its best efforts” to cause something to happen. Before closing, a common covenant by the seller would typically constitute a promise to the purchaser to permit the latter to have access to the seller’s books and records for purposes of the conduct of due diligence. Additionally, the seller may promise that the purchaser will have the right to inspect the properties, which affords an opportunity for the purchaser to evaluate the condition of the assets, verify their actual existence, and become satisfied as to the value assigned to such assets.

Another “pre-closing covenant” running from the seller to the purchaser is to the effect that “Seller will continue the operation of the Properties in the ordinary course of its business (or, where Seller is not the operator of a Property, will continue its actions as a non-operator in the ordinary course of its business).” An important covenant that goes along with the duty to continue the operation of the properties is a covenant to maintain in place, before closing, insurance and any government bonds. In addition, because the seller is in the best position to do so, a typical covenant would obligate the seller to “use reasonable efforts, consistent with industry practices in transactions of this type, to identify, with respect to all Oil and Gas Properties, the names and addresses of parties holding the Preferential Rights or Consents identified on” a schedule or exhibit to the PSA.

The important feature of the covenants that the seller puts forth to and for the benefit of the purchaser is to ensure that, before closing, the properties are maintained, administered, and operated in the same manner as they have historically been, so that at closing, the purchaser is acquiring the properties as they existed at the inception of the transaction to the extent practicable.

### *2. Post-Closing Covenants*

The PSA might impose further obligations on the parties even after the transaction is consummated. Customary among these post-closing covenants are the following: the preparation and completion of any post-closing adjustments; the payment of all sales taxes occasioned by the sale

of the interests, if any are due and payable;<sup>259</sup> and all documentary, filing and recording fees required in connection with the filing and recording of any types of conveyances; taking all actions necessary to effectuate the transfer, including the filing of applications and notices with governmental agencies; the removal of all lease and well signs indicating seller's ownership of the now-conveyed assets; and the delivery of all files and records to the purchaser.

#### *F. Termination Provisions*

A matter of equal importance to both the seller and the purchaser is an articulation of the circumstances under which a party may terminate the agreement, with no further liability to the other. These provisions are sometimes called "walkaways," or "contractual outs." A typical PSA sets forth the following events or occurrences that give rise to a right of termination by one party or the other: (a) a material, uncured breach by the other party; (b) by mutual consent of the parties; (c) if the transaction has not been closed by some stated date, despite the good faith exercise of diligence of the parties; (d) if a certain monetary threshold has been met, either in reference to a title defect or an environmental defect; or (e) if the transaction cannot be closed by reason of a legal impediment, such as an injunction or other statutory or regulatory impediment.

Typically, if the agreement terminates pursuant to one of these circumstances, the parties will "walk away," from each other. The PSA will address the disposition of any deposit posted by the purchaser but will not, however, release a party from liability for damages if its action or inaction was the cause of the termination.

A party electing to terminate an agreement for the purchase and sale of property must attempt to comply with the terms of the agreement as they pertain to the manner in which termination is to be made effective. For example, in one case,<sup>260</sup> the court held that notice of termination provided by e-mail was an insufficient dispatch of such notice, as the agreement required the termination to be "in writing."<sup>261</sup> The court rejected the argument that an electronic communication was authorized and effective under the Louisiana Uniform Electronic Transactions Act,<sup>262</sup>

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259. The transfer of assets in connection with a sale of producing oil and gas assets is excluded from sales taxation, as it constitutes the isolated or occasional sale of tangible personal property by a person not engaged in such business. *See* LA. REV. STAT. ANN. §§ 47:301(1), :301(10)(c), :303(B)(4) (2007 & Supp. 2015).

260. *White v. Strange*, 80 So. 3d 1189 (La. Ct. App. 2011).

261. *Id.* at 1193.

262. LA. REV. STAT. ANN. §§ 9:2601 to :2620 (2005 & Supp. 2015).



because that act only applies if the parties “agreed to conduct transactions by electronic means.”<sup>263</sup> That did not occur in this case, because “the box that states ‘Seller authorized the authentication of his signature or of the Purchaser’s by facsimile (fax) or e-mail’ was left unchecked.”<sup>264</sup>

If the PSA affords an opportunity for the purchaser to terminate the agreement based upon the articulated findings of any due diligence, the purchaser must comply with the requirements of such “contractual out.” For example, in one case<sup>265</sup> in which the agreement allowed the purchaser to terminate the agreement following an inspection, the right of termination was provided under the following terms:

Upon completion of Inspections, [purchaser] must provide [seller] with a copy of all inspection reports, and recognizes that such reports may be provided to others by [seller]. If [purchaser] is not satisfied with the present condition of the property as reflected in the Inspection reports, [purchaser] (1) may elect, in writing, to terminate the agreement to purchase . . . .<sup>266</sup>

The purchaser, upon receipt of the inspection report, notified the seller of its election to terminate the agreement but did not provide a copy of the report to the seller as required.<sup>267</sup> The court determined that “the trial court’s factual determination that [purchaser] breached the Agreement was not manifestly erroneous,” explaining as follows:

According to the Agreement’s inspection provision, if [purchaser] was not satisfied with the condition of the property “as reflected in the inspection reports,” he had the authority to terminate the Agreement, as long as said report was provided to [seller]. The trial court found that the “report does not state that the elevation as reflected in the survey limits the purchaser’s use of the property.” Thus, because the flood elevation survey/report simply revealed the property’s elevation statistics, coupled with [purchaser] failing to provide a copy of the document to [seller],

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263. 80 So. 3d at 1192; LA. REV. STAT. ANN. § 9:2605B(1) (providing that the Act “applies only to transactions between parties, each of which has agreed to conduct transactions by electronic means”).

264. 80 So. 3d at 1193.

265. 1100 S. Jefferson Davis Parkway, LLC v. Williams, 165 So. 3d 1211 (La. Ct. App. 2015).

266. *Id.* at 1214.

267. *Id.* at 1216–17.

it cannot be considered an inspection report as contemplated by the Agreement.<sup>268</sup>

*G. Allocation of Liability and the Associated Indemnities*

In today's environment, hardly any provision in a purchase and sale agreement is more important than the clause addressing allocation of liability and associated indemnities. One of the factors that might motivate a party to divest a producing property is the concern of future liability to plug and abandon wells, stemming from the potential of a "legacy lawsuit" filed in respect of allegations that the property has not been properly remediated.<sup>269</sup>

The conflicting interests of the seller and purchaser are obvious. The seller will seek to pass along to the purchaser all responsibility for any and all actions then pending, or to be instituted in the future, that seek damages for the environmental condition of the property. The seller will likely want to spell out this allocation of liability in the clearest of terms. In dire contrast, the purchaser will seek to have the seller retain responsibility for all potential damages caused by activities occurring before the effective date. The purchaser has an equal interest in spelling out this allocation of liability in the clearest of terms.

If the purchaser prevails in keeping the seller "on the hook" for pre-effective date activities, the matter so identified will be characterized as a "retained obligation," for which seller alone remains responsible. If the seller is successful in having the purchaser assume responsibility for pre-effective date activities, the matter so identified will be characterized as an "assumed obligation." Even if the purchaser assumes the obligation, however, the seller—as the assignor under the ultimate assignment—remains responsible to the lessor.<sup>270</sup> At the same time, the assignor may be

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268. *Id.* at 1217.

269. "Legacy litigation" refers to hundreds of cases filed by landowners seeking damages from oil and gas exploration companies for alleged environmental damage in the wake of this Court's decision in *Corbello v. Iowa Production*, [850 So. 2d 686 (La. 2003)]. These types of actions are known as 'legacy litigation' because they often arise from operations conducted many decades ago, leaving an unwanted 'legacy' in the form of actual or alleged contamination." *Marin v. Exxon Mobil Corp.*, 48 So. 3d 234, 238 n.1 (La. 2010).

270. "An assignor or sublessor is not relieved of his obligations or liabilities under a mineral lease unless the lessor has discharged him expressly and in writing." LA. REV. STAT. ANN. § 31:129 (2000); *see also Kleas v. Mayfield*, 404 So. 2d 500 (La. Ct. App. 1981).

relieved of liability to the Office of Conservation if the parties undertake to establish a site-specific trust account.<sup>271</sup>

Regardless of how these matters play out, the environmental due diligence conducted by the purchaser is of critical importance so that the purchaser and seller might be informed of the condition of the property, and the liabilities attached. As the Louisiana Supreme Court has stated: “The rule of indemnity is founded upon the general obligation to repair the damage caused by one’s fault and the moral maxim that ‘no one ought to enrich himself at the expense of another.’”<sup>272</sup>

A “knock-for-knock” indemnity arrangement is one in which party A promises to indemnify party B from liabilities associated with party A’s activities—and those of its employees—and vice versa.<sup>273</sup> In its simplest form, this arrangement is purely bilateral, but it is common to add, by way of definition, a reference to the representatives associated with each of the parties, such as “party A, its contractors, subcontractors and consultants, its directors, officers, employees and agents, and its parent, affiliated or subsidiary companies.” One court characterized a “knock-for-knock” indemnity agreement as one “whereby each party to the contract would indemnify the other for claims brought by its employees or the employees of subcontractors it hired.”<sup>274</sup>

The important topic of indemnity is well beyond the scope of this Article, and is frequently litigated in the Bayou State’s oil patch.<sup>275</sup> Critical to the negotiating and drafting of an indemnity clause is the basis for the undertaking. Is it based on commitments made by the parties, or purely on the fault of a party? Does it contain a temporal feature as to when the triggering event occurs?

The preparation of an effective indemnity provision requires a thorough understanding of a variety of public policy considerations, many of which involve legal limitations on the construction of language purporting to require a party to indemnify another for the fault of that other, as well as issues of clarity, “talismanic” language, and conspicuousness.<sup>276</sup>

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271. See *supra* Part IV.C.3.c.

272. *Ebinger v. Venus Constr. Corp.*, 65 So. 3d 1279, 1283 (La. 2011).

273. See *Weathersby v. Conoco Oil Co.*, 752 F.2d 953, 957 (5th Cir. 1984).

274. *Id.*

275. See, e.g., *Noble Energy, Inc. v. Prospective Inv. & Trading Co.*, No. 09-748, 2011 WL 6046623 (W.D. La. Dec. 5, 2011).

276. For excellent commentary on this important topic, see J. Jay Caraway, *Allocation of Contract and Tort Liability for P&A, Site Restoration and Related Issues*, 41 ANN. INST. ON MIN. L. 1 (1994), and Marilyn C. Maloney and John Almy, *Indemnity Agreements in Mergers and Acquisitions*, CENTER AM. & INT’L L., [www.cailaw.org/institute-for-energy-law/onlineeducation/2014/mergers-and-acquisitions.html](http://www.cailaw.org/institute-for-energy-law/onlineeducation/2014/mergers-and-acquisitions.html) (last visited Jan. 6, 2016).

### *H. The Closing*

The “closing” is the event that culminates the process that includes due diligence and other matters. This event is the time and place at which the transaction contemplated by the PSA is consummated.

#### *1. Consummation of Transaction*

At the closing, all relevant documents are signed and the purchaser pays the purchase price, which occur to effectuate the intention of the parties. The date, time, and place of the closing are set forth in the PSA but are often rescheduled or revised to accommodate due diligence, to make necessary calculations for purchase price adjustments, or to obtain necessary consents or waivers of “pref rights.”

When all suspensive conditions—in the jargon of the common law, “conditions precedent”—to the closing have been satisfied or waived by the parties, the closing will take place. It certainly can be a face-to-face meeting, but it is often accomplished in different cities by signing and exchanging the relevant documents. Because most delays occur due to banking delays associated with the wire transfer of the purchase price, parties frequently “pre-close” the transaction the day before the actual closing date, with all executed documents being held in trust pending receipt by the seller of the purchase price.

Parties should also remain aware that they can obligate themselves to fulfill the conditions necessary for the closing. In *Ratcliff Development, L.L.C. v. Ollie Lee Corp.*,<sup>277</sup> the parties’ PSA set a closing date of October 23, 2012, and further provided that the purchaser<sup>278</sup> had an inspection period after which the purchaser could notify the seller of any title defects.<sup>279</sup> Purchaser notified the seller, who then had a 90-day period of time to cure any defects at its expense.<sup>280</sup> When the seller failed to do so, the purchaser sued for specific performance to enforce the contract.<sup>281</sup>

The seller defended by arguing “that the closing date as set forth in the original contract of 23 October 2012 was the drop-dead date unless excluded by mutual agreement of the parties pursuant to paragraph 17 of the buy-sell agreement,” an argument that the court found “to be without merit.”<sup>282</sup>

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277. 155 So. 3d 698 (La. Ct. App. 2015).

278. *Id.* at 704.

279. *Id.* at 702.

280. *Id.* at 703.

281. *Id.*

282. *Id.* at 704.

The appellate court affirmed the trial court's judgment of specific performance, stating, as follows:

We therefore find that the trial court correctly interpreted the clear terms of the Purchase Agreement. Upon Ollie Lee's failure to cure the title defect, Ratcliff had the option to seek specific performance, which required Ollie Lee to complete the act of sale under the terms of the Purchase Agreement. The trial court correctly found that the remedy of specific performance was appropriate based on the testimony and evidence presented at trial.<sup>283</sup>

### *2. Preparation of Closing Documents*

Before the actual closing, the parties consult with each other and often prepare a closing checklist to assign responsibility to various parties for the preparation and delivery of documents to be executed or delivered at the closing. On some date before the closing, both the seller and the purchaser prepare and approve a preliminary settlement statement. This statement includes the several elements or components supporting the calculation of the preliminary purchase price. Typically, the purchaser is afforded a period of time before closing to review the statement and propose any adjustments based upon information developed in its due diligence to that point in time. If the parties agree to changes proposed by the purchaser, the preliminary purchase price is adjusted accordingly. If not, the parties might nevertheless use the purchase price proposed by the seller, knowing that further adjustments can be made at a future date after the closing.

### *3. Typical Closing Documents*

An array of documents are typically executed at the closing. If the seller is the operator of the properties being sold, the parties execute a change-of-operator form to be filed with all applicable regulatory bodies. In Louisiana, this is an Amended Permit to Drill, changed to reflect the new operator.<sup>284</sup> Parties also execute letters in lieu, simple letter form agreements, which are directed to the purchaser of production, informing it of the change in ownership—and thus the asset purchaser's entitlement to proceeds of production—as of the effective date of the transaction. The letter usually ratifies any existing division order pertaining to the assets

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283. *Id.* at 707–08.

284. LA. ADMIN. CODE tit. 43, pt. XIX, §104A2 (2011).

being sold,<sup>285</sup> and also serves as the authority for the purchaser of production to commence payment of the proceeds of production to the purchaser of assets with respect to production obtained at and after the effective date to which the parties have agreed. Additionally, if the seller's assets are subject to a mortgage or security agreement, the seller will deliver appropriate releases of those encumbrances so that the assets purchased are not burdened by those mortgages.

The parties typically exchange evidence of the authority of each signatory to execute and deliver the closing documents. If the purchaser is obligated, by way of the PSA, to take over and assume any outstanding bonds, letters or credit, or other instruments of financial security or performance, the seller will be provided replacement instruments so that those instruments posted by seller will be released or cancelled. If, despite the exercise of diligence, a certain requirement contained in the PSA has not been achieved or satisfied by the date of the closing, parties might elect to execute a letter agreement that extends the date by which such closing condition must be accomplished, with a specified penalty for failure to accomplish it by such extended date. Finally, the Assignment is the most critical document to be executed, as reflects the change of ownership resulting from the consummation of the transaction.

### *I. Post-Closing Adjustments*

The purchase price paid at the closing is that amount reflected by the preliminary settlement statement that might be adjusted at or before closing based upon actual information available to the parties. At some date after the closing—often as much as 90 or 180 days later—the seller typically tenders to the purchaser a proposed final settlement statement, which reflects changes necessary to “true up” the estimates contained in the preliminary settlement statement, and reflects actual transactions that contribute to either an increase or decrease in the purchase price.<sup>286</sup> This is called a “purchase price adjustment.”

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285. A “division order” is an “instrument setting forth the proportional ownership in oil or gas, or the value thereof, which division order is prepared after examination of title and which is executed by the owners of the production or other persons having authority to act on behalf of the owners thereof.” LA. REV. STAT. ANN. § 31:138.1 (2000).

286. In the industry, to “true-up” is to refine the estimated number by taking into consideration actual transactions so as to make current and accurate the value at issue. *See Anadarko Petroleum Corp. v. Williams Alaska Petroleum, Inc.*, 737 F.3d 966, 971 (5th Cir. 2013) (“Moreover, the undisputed evidence shows that the parties’ course of performance indicates that they consistently made adjustments

The transactions that contribute to an adjustment of the purchase price might relate to the resolution of any title or environmental defect that was not concluded before closing. Additionally, revenue and expenses, both pre-closing and post-closing, are taken into consideration so as to reflect actual, rather than merely estimated, amounts. Matters that are accounted for by way of an adjustment to the purchase price customarily do not come within the ambit of an indemnity owed by one party or the other because the party has already received credit, or suffered a debit, with respect to such matters.

### *J. Miscellaneous Provisions*

The range of contractual stipulations that one might encounter in a PSA is determined by the prior experience of the parties and is unlimited in terms of the doctrine of “freedom of contract” enjoyed by such parties.

#### *1. “Freedom of Contract”<sup>287</sup>*

The doctrine of “freedom of contract” operates in connection with the agreements associated with the purchase and sale of producing properties, particularly the PSA, to allow parties to construct their own bargains by including clauses specially crafted to accomplish their intentions. The Louisiana Supreme Court describes the doctrine thus: “‘Freedom of contract’ signifies that parties to an agreement have the right and power to construct their own bargains. . . . In a free enterprise system, parties are free to contract except for those instances where the government places restrictions for reasons of public policy.”<sup>288</sup> These statements are necessary corollaries of the idea enunciated in Louisiana Civil Code article 1983, which informs that “[c]ontracts have the effect of law for the parties.”<sup>289</sup> At the same time, contracting parties are assured that they “are free to contract for any object that is lawful, possible, and determined or determinable.”<sup>290</sup>

Setting forth all of the unique or important clauses commonly encountered in PSAs would be impossible. Indeed, the generous use of the

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to the amount of payment due at a time after the contract payment date, to ‘true-up’ the actual Quality Bank adjustments from the estimated amounts.”).

287. Portions of this section constitute an adaptation of OTTINGER, *supra* note 12, ch. 2, pt. I.

288. *La. Smoked Prods., Inc. v. Savoie’s Sausage & Food Prods., Inc.*, 696 So. 2d 1373, 1380–81 (La. 1997).

289. LA. CIV. CODE art. 1983 (2015).

290. *Id.* art. 1971.

words *typically* or *customarily*, as set forth herein, should be understood in the context of the doctrine of “freedom of contract,” which might, in a proper case, operate to alter—or even exclude—the given clause. Even so, mention of a few of the “typical” or “customary” provisions is warranted.

## 2. *Material Adverse Effect Clause*

An important clause often encountered in a PSA is the “Material Adverse Effect Clause.” A clause of this type is an attempt by the parties to anticipate extreme changes in circumstance that might permit a party to withdraw from the contract or propose and effectuate a revision to the terms of the PSA.

An example of such a provision might read, as follows:

“Material Adverse Effect” means any circumstance, change, effect, condition, development, event or occurrence that has resulted in, or would be reasonably likely to result in, a material adverse effect on the value of the Assets, taken as a whole; *provided, however*, none of the following circumstances, changes, effects, conditions, developments, events or occurrences shall be deemed to constitute, or shall be taken into account in determining whether, a Material Adverse Effect has occurred or would be reasonably likely to occur: (a) any changes in Hydrocarbon or other commodity prices, or in general conditions in the industries or markets in which Seller operates; (b) changes, events, effects, or developments generally applicable to the oil and gas industry in the State of Louisiana, or to the oil and gas industry as a whole; (c) national or international political conditions, including any engagement in hostilities, whether or not pursuant to the declaration of a national emergency or war, or the occurrence of any military, terrorist, or criminal attack; (d) changes in Law, GAAP,<sup>291</sup> or the interpretation thereof from and after the

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291. “GAAP” is the acronym for “Generally Accepted Accounting Principles;” it is often a defined term in a PSA, and might be stated as:

Generally accepted accounting principles, applied on a consistent basis, as set forth in Opinions of the Accounting Principles Board of the American Institute of Certified Public Accountants and/or in statements of the Financial Accounting Standards Board and/or their respective successors and which are applicable in the circumstances as of the date in question. Accounting principles are applied on a “consistent basis” when the accounting principles observed in a current period are comparable in all material respects to those accounting principles applied in a preceding period.



Execution Date; (e) the announcement or pendency of this Agreement, actions contemplated by this Agreement or the other Transaction Documents, or the consummation of the transactions contemplated hereby or thereby; (f) matters that will be reflected as a downward adjustment in the determination of the Adjusted Purchase Price as of the Closing Date; (g) changes or developments in financial or securities markets, or the economy in general, including any changes in currency exchanges rates, interest rates, monetary policy, or inflation; (h) effects of weather, meteorological events, natural disasters, or other acts of God; (i) actions or inaction of Governmental Authorities; (j) any decrease in the market price of any Party's (or such Party's parent's) publicly traded equity securities; (k) the downgrade in the rating of any debt or debt securities of any Party (or such Party's parent); (l) the effects of any action or inaction by Seller or any Affiliate of Seller at the request or direction of Purchaser; provided that actions or inactions taken (or omitted to be taken, as applicable) with Purchaser's consent shall not be considered to be taken (or omitted to be taken, as applicable) at the request or direction of Purchaser; (m) natural declines in well performance or the results of Hydrocarbon reserves or production from any Well; or (n) any matters set forth or described in the Disclosure Schedules on the Execution Date, or that Purchaser has knowledge prior to the Execution Date.

A more abbreviated example of such a clause might read: "There shall occur no adverse material change to the Properties or Seller's interest therein from the date of this letter to Closing." The meaning of this precise provision was litigated in *Esplanade Oil & Gas, Inc. v. Templeton Energy Income Corp.*<sup>292</sup> After signing a letter agreement containing this clause designated in the agreement as condition 4(c), Templeton, as purchaser, refused to consummate the transaction, noting the recent drop in the price of oil "had, in its opinion, 'adversely affected' the Properties and that Templeton did not consider it 'feasible' to negotiate a definitive purchase and sale agreement as required by the letter agreement."<sup>293</sup> The court rejected this contention, and explained:

Nothing in the letter agreement itself hints of any other construction. Nor does the plain meaning of the words lead to absurd consequences. The essential purpose of the price agreement was to fix the value at which the trade would later be finalized. If

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292. 889 F.2d 621 (5th Cir. 1989).

293. *Id.* at 623.

increases or decreases in market value were to govern, the price term would have been redundant. Therefore, Templeton's attempt to pour new content into the language of condition 4(c) in an effort to avoid what market fluctuations caused to be an economically unwise business decision is unavailing. We conclude that condition precedent 4(c) was fulfilled.<sup>294</sup>

The lesson to be learned from *Templeton* is that the words selected by the parties matter, and if the parties intended to allow the purchaser to escape from its commitment to purchase, in the event of significant changes in commodity prices, such intention should be explicitly set forth in the "Material Adverse Effect Clause."

### 3. Choice of Law

Finding that the parties have stipulated that the law of a state other than Louisiana controls the relationship created by the PSA is not uncommon. Parties frequently chose Texas law to control, particularly where both parties are domiciled in Texas. Louisiana law states that contracts in one state may be made with reference to the laws of another state, so long as the law chosen has a significant relationship to the contract or the parties.<sup>295</sup> One court elaborated:

Traditionally, Louisiana courts have found that parties to a contract may agree to have their contract controlled by the law of a state other than their own, provided the terms of the contract are not against the public policy of the state in which the contract is to be performed.<sup>296</sup>

In *Whitehurst v. James Noel Flying Services*,<sup>297</sup> the court stated as follows:

It is well established that where the parties stipulate the state law governing the contract, Louisiana conflict of laws principles require that the stipulation be given effect, unless there is statutory or jurisprudential law to the contrary or strong public policy considerations justifying the refusal to honor the contract as

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294. *Id.* at 624.

295. *Davis v. Humble Oil Refining Co.*, 283 So. 2d 783 (La. Ct. App. 1973); *Wellcraft Marine, Inc. v. Dauterive*, 482 So. 2d 1002 (La. Ct. App. 1986).

296. *Walnut Equip. Leasing Co., Inc. v. Moreno*, 643 So. 2d 327, 330 (La. Ct. App. 1994).

297. 509 So. 2d 1035 (La. Ct. App. 1987).

written. A choice of law provision in a contract is presumed valid until it is proved invalid. The party seeking to prove such a provision is invalid bears the burden of proof.<sup>298</sup>

The prerogative for the parties to invoke the law of a state other than Louisiana—in which the mineral leases are located—to control their relationship, is governed by the Civil Code. As a general rule, “an issue in a case having contacts with other states is governed by the law of the state whose policies would be most seriously impaired if its law were not applied to that issue.”<sup>299</sup> Courts are directed to evaluate two factors when determining which state’s law should govern under this general rule:

- (1) the relationship of each state to the parties and the dispute; and
- (2) the policies and needs of the interstate and international systems, including the policies of upholding the justified expectations of parties and of minimizing the adverse consequences that might follow from subjecting a party to the law of more than one state.<sup>300</sup>

Thus, the enforceability of the parties’ choice of governing law from a state other than the Bayou State is determined on a mixture of facts and policy considerations. The principal limitation on the application of the law of a foreign state is that regimes of property law from the selected state that are antagonistic or repugnant to Louisiana’s civil law tradition, will not generally be enforced, while matters which are more procedural in nature might be tolerated.

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298. *Id.* at 1037 (citations omitted); *see also* *Cont’l Eagle Corp. v. Tanner & Co. Ginning*, 663 So. 2d 205 (La. Ct. App. 1995); *Lewis v. Townsend*, 108 So. 3d 184 (La. Ct. App. 2012).

299. LA. CIV. CODE art. 3515 (2015). For conventional obligations specifically, there are additional enumerated factors to consider:

That state is determined by evaluating the strength and pertinence of the relevant policies of the involved states in the light of: (1) the pertinent contacts of each state to the parties and the transaction, including the place of negotiation, formation, and performance of the contract, the location of the object of the contract, and the place of domicile, habitual residence, or business of the parties; (2) the nature, type, and purpose of the contract; and (3) the policies referred to in Article 3515, as well as the policies of facilitating the orderly planning of transactions, of promoting multistate commercial intercourse, and of protecting one party from undue imposition by the other.

*Id.* art. 3537; *see also id.* art. 3540 (“All other issues of conventional obligations are governed by the law expressly chosen or clearly relied upon by the parties, except to the extent that law contravenes the public policy of the state whose law would otherwise be applicable under Article 3537.”).

300. *Id.* art. 3515.

In some cases, Louisiana law will govern the contract regardless of the weighing of these factors or the intent of the parties. One exception to the general rule applies to contracts involving real rights in immovables that are located in Louisiana: “Real rights in immovables situated in this state are governed by the law of this state. Real rights in immovables situated in another state are governed by the law that would be applied by the courts of that state.”<sup>301</sup> Consequently, a PSA covering mineral leases corresponding to land in Louisiana is governed by Louisiana law.

#### 4. Forum Selection Clauses

A “forum selection clause” is a provision stipulating that any litigation between the parties to a PSA must be filed and prosecuted in an identified court in a stipulated parish or county. Some have expressed doubt as to the validity of such clauses, as Louisiana Code of Civil Procedure article 44(A) clearly and unambiguously prohibits waiver of the Code’s venue provisions in advance of the litigation.<sup>302</sup> The appellate courts in Louisiana have been inconsistent in the treatment of such clauses.<sup>303</sup>

In *The Bremen v. Zapata Off-Shore Co.*,<sup>304</sup> the United States Supreme Court stated that “such clauses are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be ‘unreasonable’ under the circumstances.”<sup>305</sup>

The Louisiana Supreme Court resolved the same issue in one case,<sup>306</sup> declaring as follows:

Based on our review of the law, we find no reason for Louisiana to deviate from the general rule set forth by the United States Supreme Court that contractual forum selection clauses are *prima facie* valid. We hold that such clauses should be enforced in Louisiana unless the resisting party can “clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching . . . [or that] enforcement would contravene a strong public policy of the forum

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301. *Id.* art. 3535 (“Whether a thing is an immovable is determined according to the substantive law of the state in which the thing is situated.”).

302. LA. CODE CIV. PROC. art. 44(A) (2015).

303. *Compare* *Thompson Tree & Spraying Serv., Inc. v. White Spinner Constr., Inc.*, 68 So. 3d 1142 (La. Ct. App. 3d 2011), *with* *Rising Res. Control, Inc. v. KIE Commodities & Fin., L.L.C.*, 80 So. 3d 1217 (La. Ct. App. 1st 2011).

304. 407 U.S. 1 (1972).

305. *Id.* at 10.

306. *Shelter Mut. Ins. Co. v. Rimkus Consulting Grp., Inc. of La.*, 148 So. 3d 871 (La. 2014).

in which suit is brought, whether declared by statute or by judicial decision.” This court has long recognized that the freedom to contract is an important public policy.<sup>307</sup>

If the parties have incorporated an arbitration clause into their PSA, however, this clause is ineffectual—except perhaps in relation to a suit to confirm or vacate an award. In other words, an agreement to arbitration would be enforced, rendering immaterial a conflicting selection of a forum to resolve disputes through traditional litigation.<sup>308</sup>

## V. REMEDIES FOR BREACH OF THE PURCHASE AND SALE AGREEMENT

Parties to a PSA must prepare for the possibility that the other party may fail to perform its respective obligations under the contract. As a bilateral contract,<sup>309</sup> a PSA is susceptible of being breached by either party. On the one hand, the seller might fail or refuse to complete the transaction by refusing to close and execute the assignment. On the other hand, the purchaser might wish to “walk away” from the transaction, refusing to pay the purchase price. In any case, the law provides an array of remedies to the party who seeks to either enforce the contract to sell or recover damages resulting from the breach by the other party.<sup>310</sup>

### A. Specific Performance

Specific performance is the remedy that would most fundamentally place the parties in the position in which they anticipated to find themselves had the parties fully performed. This remedy most perfectly achieves the bargain sought by the parties, as embodied in their agreement.

Under Louisiana law, the general rule is that a party is entitled to the remedy of specific performance.<sup>311</sup> This idea is reflected in Louisiana Civil Code article 2623, which provides: “[A contract to sell] gives either party the right to demand specific performance.”<sup>312</sup> Likewise, Louisiana Civil

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307. *Id.* at 881 (quoting *Bremen*, 407 U.S. at 13).

308. *See* *Univ. of La. Monroe Facilities, Inc., v. JPI Apartment Dev., L.P.*, 151 So. 3d 126, 132 (La. Ct. App. 2014), *writ denied* 158 So. 3d 818, 820 (La. 2015) (“Louisiana law favors arbitration as a preferred method of alternative dispute resolution.”).

309. *See* LA. CIV. CODE art. 1908 (2015) (“A contract is bilateral . . . when the parties obligate themselves reciprocally, so that the obligation of each party is correlative to the obligation of the other.”).

310. *See id.* arts. 1989–2011 (providing for remedies for the breach of conventional obligations generally).

311. *Rutherford v. Impson*, 366 So. 2d 944, 946 (La. Ct. App. 1978).

312. LA. CIV. CODE art. 2623.

Code article 1986, provides more generally: “Upon an obligor’s failure to perform an obligation to deliver a thing . . . or to execute an instrument, the court *shall* grant specific performance plus damages for delay if the obligee so demands.”<sup>313</sup>

Despite the general rule that parties are entitled to the remedy of specific performance, the Louisiana Civil Code makes clear that a court has discretion to deny such a remedy when doing so would be impracticable.<sup>314</sup> Relying on this authority, Louisiana courts have limited the use of specific performance in the context of a PSA under certain circumstances.

The Louisiana Supreme Court described the rationale behind the limitations to the remedy of specific performance in the case of *Lombardo v. Deshotel*,<sup>315</sup> in which the court noted:

Above all others, the creditor enjoys the right to demand, insofar as is practicable, the specific performance of the obligation. Here, however, the distinction between obligations to do or not to do is of great moment, since an obligation to give a thing is always susceptible of forced execution—unless, of course, performance has become impossible or impracticable—while this is not always the case with an obligation to do, or one not to do, where the liberal principle of modern law that prevents laying hands on a person to force him physically to do something is always taken into account.<sup>316</sup>

Thus, if “specific performance is impracticable or . . . the obligation the obligor has failed to perform is an obligation to do,” a court may decide to not grant specific performance, limiting the obligee’s remedy to compensatory damages.<sup>317</sup> In addition, in the context of a “take-or-pay” case,<sup>318</sup> a Louisiana court gave a more detailed account of potential limitations on the obligee’s ability to demand specific performance: “An obligee has a right to specific performance for breach of contract except when it is impossible, greatly disproportionate in cost to the actual

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313. *Id.* art. 1986 (emphasis added).

314. *Id.*

315. 647 So. 2d 1086 (La. 1994).

316. *Id.* at 1090 (citations omitted).

317. *Id.* at 1091 (citing as examples Louisiana Civil Code article 1986 cmt. b, c (1984) and *J. Weingarten, Inc. v. Northgate Mall, Inc.*, 404 So. 2d 896 (La. 1981)).

318. *Pogo Producing Co. v. Sea Robin Pipeline Co.*, 493 So. 2d 909, 919 (La. Ct. App. 1986). In the interest of full disclosure, this Author represented the plaintiff-producer in this case.

damages caused, no longer in the creditor's interest, or of substantial negative effect upon the interest of third parties."<sup>319</sup>

If a court finds that such limitations do not apply, the general rule will govern and the aggrieved party will have a right to demand specific performance. In such a case, the court will direct the breaching party to perform a specific act and, in the case that party fails to comply, the court "may direct the act to be done by the sheriff or some other person appointed by the court, at the cost of the disobedient party, and with the same effect as if done by the party."<sup>320</sup> However, it is important to note that, if the act involves merely the transfer of ownership of an immovable, the judgment is self-operative and thus the court will not need to direct a third person to perform any set task.<sup>321</sup>

Closely associated with the remedy of specific performance is Louisiana Civil Code article 1988, which provides that a "failure to perform an obligation to execute an instrument gives the obligee the right to a judgment that shall stand for the act."<sup>322</sup> Thus, a party to a PSA who refuses to abide by a judgment of specific performance cannot, by its disobedience, defeat the consummation of the transaction. Rather, the obligee has the "right to a judgment that shall stand for the act."<sup>323</sup> Consequently, in *Kinberger v Drouet*,<sup>324</sup> the court explained: "If the plaintiff has the right to the title, it will be so decreed, and defendant . . . will be condemned to sign the deed. If she refuses to sign, then the decree will be the title."<sup>325</sup>

A recent suit involving a failed purchase and sale transaction of producing oil and gas properties in Louisiana provides insight into the workings of a PSA and the remedy of specific performance. In *J. B. Hanks Co., Inc. v. Shore Oil Co.*,<sup>326</sup> the parties entered into a PSA for the transfer of certain producing assets in Livingston Parish from Shore to Hanks.<sup>327</sup> The parties entered into a confidentiality agreement, and then negotiated and executed a PSA.<sup>328</sup> The PSA provided for a closing to occur on

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319. *Id.* at 919.

320. LA. CODE CIV. PROC. art. 2504 (2015).

321. *Id.* cmt. b.

322. LA. CIV. CODE art. 1988 (2015).

323. *Id.*

324. 90 So. 367 (La. 1922).

325. *Id.* at 372.

326. No. 97-00040-BAJ-SCR, 2014 WL 268689 (M.D. La. Jan. 23, 2014). As explained, and in the interest of full disclosure, your Author served as a Special Master in this case. Nothing is disclosed or discussed herein that is not embodied in the court's Ruling and Order.

327. *Id.* at \*18.

328. *Id.* at \*2.

September 9, 1994.<sup>329</sup> The Purchase Price for all of the assets was originally set at \$450,000.<sup>330</sup>

After conducting due diligence, the purchaser asserted, as a title defect, the fact that the seller had not properly accounted to a particular lessor for royalties in accordance with the terms of a mineral lease. The seller disagreed that this constituted a “material defect[] in title, percentage interest, or deficiency in the Documents discovered by Purchaser,”<sup>331</sup> and litigation ensued.

The court—in adopting the Report and Recommendation of the Special Master—deemed “most important,” the fact that continued receipt by the lessors under the relevant lease of royalties as calculated by Shore, “viewed in the worst light . . . would probably result in the assessment of monetary damages rather than dissolution of the Lease.”<sup>332</sup> Dissolution of a mineral lease for improper payment of royalties—assuming it was improper—is a disfavored remedy.<sup>333</sup>

The court held that the assertion by the purchaser with respect to the manner of payment of royalties under this lease did not meet the standards of the PSA as constituting a “defect in title.”<sup>334</sup> The court concluded that, “in the absence of the timely assertion of a valid ‘defect in title,’ the PSA confers options only upon the Seller, not the Purchaser.”<sup>335</sup> The court finally found that the purchaser had waived any defects not asserted:

Having not asserted, on or before the stipulated date (September 27, 1994), a valid “defect in title,” the Purchaser waived all defects not asserted. At that point, the Purchaser was obligated to appear at the Closing on the Closing Date and conclude the transaction contemplated by the PSA. By failing to do so, the [court] determines that Shore had no further obligation to convey the Assets to the Purchaser.<sup>336</sup>

The case of *Whitbeck v. Champagne*<sup>337</sup> involved an action seeking specific performance to require a purchaser to consummate the transaction

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329. *Id.*

330. *Id.* at \*19. The Purchase Price was later reduced to \$437,500.00, when a third party exercised a “preferential right to purchase” a portion of the assets. *Id.* at \*2.

331. *Id.* at \*3–5.

332. *Id.* at \*11.

333. *Id.*

334. *Id.* at \*13.

335. *Id.*

336. *Id.* at \*14.

337. 149 So. 3d 372 (La. Ct. App. 2014).



contemplated by a PSA affecting residential properties.<sup>338</sup> The agreement afforded the purchaser an inspection period of 15 days to make all inspections of the property.<sup>339</sup> The purchaser availed itself of this right of inspection but did not raise any concerns within the 15-day period.<sup>340</sup> By virtue of not raising any objections to the condition of the property, the purchaser waived the right to complain about the condition.<sup>341</sup>

The parties set a closing date, but the purchaser informed the seller on the morning of the closing that it would not close the transaction because of information received from a third party that the home had a “mold and mildew issue.”<sup>342</sup> The seller, although not obligated to do so contractually, gave the purchaser a further opportunity to “take whatever steps they deemed necessary to satisfy themselves that the Big Lake home was free of mold and mildew.”<sup>343</sup> After the purchaser persisted in refusing to close the transaction, the seller filed suit for specific performance.<sup>344</sup> After discovery was completed, the seller filed a motion for summary judgment, which the court granted.<sup>345</sup> The trial court said:

The Champagnes were given carte blanche to inspect the house by the Whitbecks, who asserted all through this process that they had nothing to hide. The Champagnes were free to take any measures necessary to assure there were no mold or structural defect present in the Big Lake house, including tearing out the sheetrock in the bedroom in question, as recommended by their realtor. The Champagnes failed to do so.<sup>346</sup>

The judgment of specific performance was affirmed on appeal, and additional attorney’s fees were awarded to the sellers.<sup>347</sup>

In another recent case,<sup>348</sup> the purchaser was entitled to specific performance of the PSA, because inaction on the part of the seller to cure the title to the property did not constitute the seller’s “reasonable inability to deliver merchantable title within the time specified.”<sup>349</sup> Specifically, the

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338. *Id.* at 375.

339. *Id.*

340. *Id.* at 376–77.

341. *Id.* at 376.

342. *Id.* at 377 (internal quotation marks omitted).

343. *Id.*

344. *Id.* at 378.

345. *Id.* at 378–79.

346. *Id.* at 381–82.

347. *Id.* at 386.

348. *Ratcliff Dev., L.L.C. v. Ollie Lee Corp.*, 155 So. 3d 698 (La. Ct. App. 2015).

349. *Id.* at 707.

purchaser was entitled to specific performance, because the seller failed to comply with the terms of the PSA by failing to complete the monition process and cure the title defect, after which the seller was entitled to pursue the fulfillment of the agreement through a demand for specific performance.<sup>350</sup>

### *B. Money Damages*

Although specific performance is the preferred remedy for a breach of a PSA, that remedy might not be available if, for example, the seller has sold the property to a third person who is protected by the “public records doctrine.”<sup>351</sup> In such a case, the remedy of the purchaser might be one of money damages.

#### *1. Duty to Mitigate*<sup>352</sup>

Although it is a defensive doctrine usually presented in a tort action, a plaintiff is clearly obliged to exercise reasonable efforts to mitigate damages where possible.<sup>353</sup> The duty to mitigate originated judicially as a “natural consequence of the principle stated in C.C. Art. 1903 (1870).”<sup>354</sup> That duty is now codified in Louisiana Civil Code article 2002, which provides, as follows: “An obligee must make reasonable efforts to mitigate the damage caused by the obligor’s failure to perform. When an obligee fails to make these efforts, the obligor may demand that the damages be accordingly reduced.”<sup>355</sup>

This article adjusts the conflict of interests that would otherwise exist when an obligee neglects to mitigate his damages and thereby exposes the obligor to further liability for consequences of the obligor’s failure to perform that were reasonably avoidable by the obligee. The purpose of the codally imposed obligation of the obligee to take reasonable steps to minimize its damages, has been explained by the Louisiana Supreme Court,<sup>356</sup> as follows:

The doctrine of mitigation of damages applies in this state. This doctrine imposes on the injured person a duty to exercise

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350. *Id.*

351. LA. CIV. CODE art. 3338 (2015).

352. Portions of this section constitute an adaptation of OTTINGER, *supra* note 12, ch. 13, pt. VI.

353. LA. CIV. CODE art. 2002.

354. *Id.* art. 2002 cmt. a.

355. *Id.* art. 2002.

356. *Lombardo v. Deshotel*, 647 So. 2d 1086, 1092 (La. 1994).

reasonable diligence and ordinary care in attempting to minimize his damages after the injury has been inflicted. The care and diligence required of him is the same as that which would be used by a man of ordinary prudence under like circumstances. He need not make extraordinary efforts or do what is unreasonable or impractical in his efforts to minimize the damages, but his efforts to minimize them must be reasonable and in accordance with the rules of common sense, good faith and fair dealing.<sup>357</sup>

## 2. *Stipulated Damages*

A stipulated damages clause—or a “penal clause”—is “designed to both fix the damages caused by nonperformance of the principal obligation and act as a constraint to encourage performance of that obligation.”<sup>358</sup> Courts have consistently held that “a stipulated damage clause fixes the amount of all damages that may be recovered, and actual damages may not be awarded.”<sup>359</sup> Louisiana Civil Code article 2005, provides, as follows: “Parties may stipulate the damages to be recovered in case of nonperformance, defective performance, or delay in performance of an obligation. That stipulation gives rise to a secondary obligation for the purpose of enforcing the principal one.”<sup>360</sup>

In *Utley-James of Louisiana, Inc. v. State, Division of Administration*,<sup>361</sup> the court described the stipulated damages clause, as follows: “Under Louisiana law, a stipulated damages clause is designed to fix the measure of damages in advance and to constrain the timely performance of the principal obligation. No showing of pecuniary or other actual damage is required to enforce the clause.”<sup>362</sup> Another court has further explained: “Stipulated damages may be modified by the court if they are so manifestly unreasonable as to be contrary to public policy. Stipulated damages should reasonably approximate the damages suffered by the obligee and not be penal.”<sup>363</sup>

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357. *Aultman v. Rinicker*, 416 So. 2d 641, 645 (La. Ct. App. 1982) (internal citations omitted).

358. *Phillippi v. Viguerie*, 606 So. 2d 577, 579 (La. Ct. App. 1992) (citing *Heeb v. Codifer & Bonnabel, Inc.*, 110 So. 2d 178 (La. 1926)).

359. *Grimsley v. Lenox*, 643 So. 2d 203, 206 (La. Ct. App. 1994) (citing *Gremillion’s Heirs v. Rapides Parish Police*, 493 So. 2d 584 (La. 1986); *Rabin v. Blazas*, 537 So. 2d 221 (La. Ct. App. 1988)).

360. LA. CIV. CODE art. 2005.

361. 671 So. 2d 473 (La. Ct. App. 1995).

362. *Id.* at 476.

363. *Carney v. Boles*, 643 So. 2d 339, 343 (La. Ct. App. 1994).

### C. Attorney's Fees

The well-established rule in Louisiana is that one may not recover attorney's fees from a defendant, unless these fees are authorized by contract or statute.<sup>364</sup> A court has explained that “[a]n award of attorney fees is a type of penalty imposed not to make the injured party whole, but rather to discourage a particular activity on the part of the opposing party.”<sup>365</sup> Thus, for a party to recover attorney's fees incurred as a consequence of the breach of the other party to a PSA, that agreement must include a contractual basis for the award of such fees.

### D. Prescription

In Louisiana, the concept of “statute of limitations” is known as liberative prescription. Article 3447 of the Louisiana Civil Code states that “[l]iberative prescription is a mode of barring of actions as a result of inaction for a period of time.”<sup>366</sup> “The fundamental purpose of a prescription statute is to afford security of mind to a defendant and protect against a stale claim,”<sup>367</sup> as well as “to afford a defendant economic and psychological security if a cause of action is not pleaded timely, and to protect the defendant from stale claims and the loss of relevant proof.”<sup>368</sup> Louisiana jurisprudence is well settled that the “character the plaintiff has given his action by his pleadings must govern us in determining the prescription applicable to it.”<sup>369</sup> Thus, depending on the nature of the claim brought by a party to a PSA, the relevant prescriptive period is, generally speaking, either five years or ten years.

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364. See *Chauvin v. La Hitte*, 85 So. 2d 43, 43 (La. 1956) (“On numerous occasions this court has said that ordinarily attorney's fees are not assessable as an item of damages unless provided for by law or contract.”); *Hernandez v. Harson*, 111 So. 2d 320, 327 (La. 1959) (“It is well recognized in the jurisprudence of this Court that as a general rule attorney's fees are not allowed except where authorized by statute or contract.”).

365. *Langley v. Petro Star Corp. of La.*, 792 So. 2d 721, 723 (La. 2001).

366. LA. CIV. CODE art. 3447.

367. *Merrit v. Adm'rs of the Tulane Edu. Fund*, 639 So. 2d 881, 882 (La. Ct. App. 1994).

368. *Terrel v. Perkins*, 704 So. 2d 35, 38 (La. Ct. App. 1997).

369. *Fishbein v. State ex rel. La. Univ. Health Serv. Ctr.*, 898 So. 2d 1260, 1265 (La. 2005).

### 1. *Applicable Prescriptive Period*

Before 2006, the prescriptive period to enforce a PSA, or assert a breach thereunder, was ten years.<sup>370</sup> In 2006, Louisiana Revised Statutes section 9:5645 was enacted,<sup>371</sup> which now provides a five-year prescriptive period: “An action for the breach or other failure to perform a contract for the sale, exchange, or other transfer of an immovable is prescribed in five years.”<sup>372</sup>

### 2. *Unreasonable Delay in Seeking Relief*

Even though a period of five years exists to file a suit in respect of a “breach or other failure to perform” a PSA,<sup>373</sup> this does not mean that a timely filed suit cannot be subject to dismissal on the merits, based upon the dilatory conduct of one party. The courts have held that one who seeks specific performance of an agreement to sell must institute his suit within a reasonable time and before any material change affecting the interest of the parties has taken place.<sup>374</sup>

For example, in *Joffrion v. Gumbel*,<sup>375</sup> the Louisiana Supreme Court summarized the general rules underlying specific performance of a contract to sell land and stated the “well-recognized rule” as follows:

The general rule is that he who seeks performance of a contract for the conveyance of land must show himself ready, desirous, prompt, and eager to perform the contract on his part. Therefore unreasonable delay in doing these acts which are to be done by him will justify and require a denial of relief. No rule respecting the length of delay which will be fatal to relief can be laid down, for each case must depend on its peculiar circumstances.<sup>376</sup>

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370. A PSA was subject to the general rule: “Unless otherwise provided by legislation, a personal action is subject to a liberative prescription of ten years.” LA. CIV. CODE art. 3499.

371. Act No. 701, 2006 La. Acts 2598, 2598–99.

372. LA. REV. STAT. ANN. § 9:5645 (2007).

373. *See id.*

374. *J.B. Hanks Co. v. Shore Oil Co.*, No. 97-000040-BAJ-SCR, 2014 WL 268698, at \*29–30 (M.D. La. Jan. 23, 2014).

375. 48 So. 1007 (La. 1909).

376. *Id.* at 1012.

The case of *Schluter v. Gentilly Terrace Co.*<sup>377</sup> involved a dispute surrounding a bond for deed contract.<sup>378</sup> The parties' agreement stated that the purchaser would be permitted to buy three lots for a sum of \$1,800, to be paid by an initial payment of \$50 in cash, and 117 promissory notes for the balance, payable monthly, on or before the first day of each month.<sup>379</sup> The plaintiff alleged that he attempted to tender the total amount due by him at the time on the deferred payments under the contract, and the defendant refused to accept the tender and deliver to the plaintiff a deed.<sup>380</sup>

The court concluded that the plaintiff violated his bond for deed contract with the defendant by failing to pay the monthly installment notes, deeming the attempted tender made by the plaintiff both too late and insufficient.<sup>381</sup> More significantly, the court noted that the plaintiff refused to make payments and persisted in the cancellation of his contract acceptance, up until the date of his attempted tender, at which time the value of the lots had increased.<sup>382</sup> The court stated that the "[p]laintiff cannot be permitted to play the role of 'watchful waiting' all of these years, without performing his obligation, and to reap, at this late date, the benefit of it in speculative values."<sup>383</sup> The court then quoted *Joffrion* to buttress its holding.<sup>384</sup>

In yet another case,<sup>385</sup> the plaintiff tendered a written offer to purchase land to be held open for a limited duration.<sup>386</sup> The offer included an offer to purchase the land, "with 'tools, stock, seed and feed', and as 'a walk out proposition', for the cash price of \$5,000."<sup>387</sup> The offer stipulated that, if the defendant's title were found invalid or so defective that it could not be validated within a reasonable time and at a reasonable expense, then the contract would be null and void.<sup>388</sup> The offer further stated that, if the contract was accepted, the plaintiff would be required to pay the remaining balance by a specified date, or it would be forfeited.<sup>389</sup>

The plaintiff in *Goudeau v. Daigle* filed an action over eight years after the specific date upon which payment was due to "make good" on

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377. 114 So. 586 (La. 1927).

378. *Id.* at 586.

379. *Id.*

380. *Id.*

381. *Id.* at 587.

382. *Id.* at 587-88.

383. *Id.* at 588.

384. *Id.*

385. *Goudeau v. Daigle*, 37 F. Supp. 843 (E.D. La. 1941).

386. *Id.* at 844.

387. *Id.*

388. *Id.*

389. *Id.*

the offer.<sup>390</sup> The court held that the plaintiff plainly abandoned the contract which he sought to revive.<sup>391</sup> More significantly, the court articulated the perceived unfairness that would result from a decision in the plaintiff's favor.<sup>392</sup> The court stated:

Plaintiff can not fairly be permitted to press the claim that he now seeks to urge against the present defendants. The continued development of the Charenton oil field, which was brought in on September 6, 1936—after LeBlanc's death—suggests that the [new] value now attaching to “the property of Mr. Paul LeBlanc, East side Charenton” (as the offer to buy reads) in the mind of the plaintiff (who alleges himself to now be a citizen of the State of Texas) is probably a value entirely disassociated from that which led him to make his “walk-out” offer to purchase, in 1931.<sup>393</sup>

This jurisprudentially recognized limitation on the right to sue for specific performance is uniquely appropriate to the sale of producing oil and gas properties, due to the speculative nature of such assets.<sup>394</sup> As one court noted:

The business of the exploration of minerals is highly speculative and capital intensive. It involves the investment of hundreds of thousands of dollars, and the activity is extremely price sensitive. Economic fluctuations can turn a lucrative investment one month into a financial fiasco the next.<sup>395</sup>

The court in *Schluter* referred disapprovingly to the practice of “watchful waiting,” suggesting that courts will not tolerate a party “waiting” and “watching” as the value of the assets increases, only then seeking to enforce

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390. *Id.* at 845.

391. *Id.*

392. *Id.*

393. *Id.*

394. Louisiana jurisprudence is replete with cases that acknowledge the speculative nature of oil and gas activities, often resulting in a refusal to award damages based upon “mere conjecture and speculation.” *See, e.g.,* McCoy v. Ark. Natural Gas Co., 165 So. 632 (La. 1936); Ferguson v. Britt, 185 So. 287 (La. 1938); Ludeau v. Cont'l Oil Co., 78 So. 2d 170 (La. 1955); Aladdin Oil Co., v. Rayburn Well Serv., Inc., 202 So. 2d 477 (La. Ct. App. 1967); Veazey v. W. T. Burton Indus., Inc., 407 So. 2d 59 (La. Ct. App. 1981); Coon v. Placid Oil Co., 493 So. 2d 1236 (La. Ct. App. 1986).

395. *Plaquemines Parish Sch. Bd. v. State Mineral Bd.*, 615 So. 2d 1051, 1056 (La. Ct. App. 1993).

its rights.<sup>396</sup> In the “oil patch,” both in the Bayou State and elsewhere, this practice is called “laying behind the log,”<sup>397</sup> and is widely viewed with considerable disdain.

#### *E. Arbitration of Disputes*

Many agreements for the purchase and sale of oil and gas properties contain a clause requiring the arbitration of any dispute arising out of the agreement. Finding a provision involving a tiered approach to alternative dispute resolution is not uncommon. Such a provision requires first, face-to-face negotiations between higher-level officers of each party. If that is not fruitful, the agreement might then require mediation of the dispute. If that does not resolve the issue, a mechanism is provided that arbitration will resolve the dispute.

In particular, the PSA customarily provides for arbitration of disputes arising out of the conduct of due diligence—particularly disputes as to whether a title or environmental defect asserted by the purchaser is in fact a defect meeting the definition of the agreement—or to ascertain the appropriate adjustment to the purchase price. Similarly, if the parties cannot agree on a proposed purchase price adjustment, a CPA with experience in these matters might be designated to resolve the dispute. Indeed, a PSA typically identifies the party who will be designated to arbitrate or resolve the dispute, sometimes by name, but often merely by qualification or scope of experience. To designate a “title arbitrator” or “defect referee,” a clause such as the following might be used:

Any dispute shall be referred to a title attorney or other consultant experienced in the examination of title to properties of a similar character located in the state where the Assets are located mutually agreed upon by Purchaser and Seller for prompt resolution (the “Defect Referee”). The Defect Referee must have at least 10 years’ experience and must not have worked as an

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396. Schluter v. Gentilly Terrace Co., 114 So. 586, 588 (La. 1927).

397. Conduct typically called “laying behind the log” is viewed with significant disdain in the oil and gas industry. *See, e.g.*, J-O’B Operating Co. v. Newmont Oil Co., 560 So. 2d 852, 860 (La. Ct. App. 1990) (finding, in an AMI case, that a contrary ruling “would result” in an “obvious inequity,” the court noted that “the AMI parties who agreed to bear the acquisition cost of the Texaco sublease . . . shouldered the entire burden of the seismic program and thereafter the risk of drilling the [Well], at a cost in excess of ten million dollars. Appellees who bore neither the expense nor the risk of the venture now seek to participate in the proceeds from a highly successful well.”). In the interest of full disclosure, this Author represented a defendant in this suit.



employee or outside counsel for either Party or its Affiliates during the 5-year period preceding the arbitration or have any financial interest in the dispute.

In like manner, disputes as to the existence or appropriate remedial action with respect to an environmental defect asserted by the purchaser may be referred to environmental consultants or engineers, as the parties might agree.

As a general proposition, the use of alternate dispute resolution is preferred to litigation for a variety of reasons. First, the trier of fact is, by definition, a person trained or experienced in the matter in dispute. In contrast, the experience of a judge, competent as he or she might be, likely does not include the technical aspects of title, environmental, or financial matters presented in connection with producing oil and gas properties. This is particularly important as the parties might have a continuing relationship after the consummation of the transaction. Additionally, at least in theory, the resolution can be achieved very promptly and less expensively as compared to traditional civil litigation.<sup>398</sup>

If the parties so agree, the proceedings can be conducted in privacy. The parties are free to contractually provide for the confidentiality of the proceedings and all documents or exhibits filed in connection with those proceedings. There is no reference in the arbitration statute of either Louisiana<sup>399</sup> or Texas<sup>400</sup> to any requirement of privacy or confidentiality. Texas statutory law does, however, contain a general requirement of confidentiality of matters involved or presented in an “alternative dispute resolution procedure.”<sup>401</sup>

Although fundamentally a matter to be determined by the contract of the disputants, arbitrators are often required to take an oath that invokes the Code of Ethics for Arbitrators in Commercial Disputes. This Code was prepared in 1977 by a joint committee consisting of a special committee of the American Arbitration Association and a special committee of the

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398. “The traditional advantages given for arbitration over litigation are that arbitration generally proceeds faster, is less costly and allows for a more expeditious disposition of the case.” JAMES S. HOLLIDAY, JR., H. BRUCE SHREVES & DALE R. BARINGER, *LOUISIANA CONSTRUCTION LAW* § 14:5 (West, Westlaw 2015).

399. LA. REV. STAT. ANN. §§ 9:4201 to :4217 (2009).

400. TEX. CIV. PRAC. & REM. CODE ANN. §§ 171.001 to 171.098 (West Supp. 2014).

401. *Id.* § 154.073.

American Bar Association.<sup>402</sup> Both organizations have approved and recommended this Code.<sup>403</sup> Canon VI of that Code provides that “an arbitrator should keep confidential all matters relating to the arbitration proceedings and decision.”

Finally, the decision of the competent arbitrator chosen by the parties will be final, except in the most extraordinary circumstances. To the extent that a party to traditional civil litigation feels relegated to inflexibly following the rules prescribed by law, by the Code of Civil Procedure, by local court rules, and by custom and practices in a civil court, with all of the inconvenience, expense, and discomfort inherent, that same party has the right to exercise “freedom of contract,” and construct a flexible, reasonable, meaningful, inexpensive, non-intrusive, confidential, and just regime to resolve a dispute. Thus, if a client does not want its company hauled into an unfriendly forum; subjected to numerous, expensive, time-consuming, limitless depositions; giving up its computers or records to forensic examination; and potentially submitting its economic future to a decision by a trier of fact who does not know a “Pugh Clause” from Santa Claus, that client might consider including a tailored arbitration clause in its contract.<sup>404</sup>

A recent case represents the intersection between purchase price adjustments, in the sale of producing oil and gas properties, and the resolution by arbitration.<sup>405</sup> Chesapeake and BP entered into a PSA, in which Chesapeake obligated itself to sell, and BP obligated itself to purchase, certain oil and gas properties in Oklahoma for \$1.75 billion.<sup>406</sup> As is typical, the PSA allowed for adjustments to the purchase price based upon title defects or title benefits discovered by the parties before closing.<sup>407</sup> Title defects would decrease the purchase price in favor of the purchaser, and title benefits would increase the purchase price in favor of the seller.<sup>408</sup> More or less, claimed adjustments would not result in a

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402. *The Code of Ethics for Arbitrators in Commercial Disputes*, AM. ARBITRATION ASS'N, [https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG\\_003867](https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG_003867) (last visited Feb. 9, 2016).

403. *Id.*

404. For the importance and effectiveness of this ADR method in the context of oil and gas contracts, see William Pitts, *ADR in the Oil and Gas Context*, 46 ANN. INST. ON MIN. LAW 157 (1999).

405. *BP Am. Prod. Co. v. Chesapeake Exploration, LLC*, 747 F.3d 1253 (10th Cir. 2014).

406. *Id.* at 1255.

407. *Id.* at 1256.

408. *Id.*

modification of the purchase price unless they exceeded a threshold of \$35 million.<sup>409</sup>

After closing, the parties agreed on title defects in the amount of \$116,234,556.<sup>410</sup> The PSA had an arbitration provision relative to disputed title defects and disputed title benefits.<sup>411</sup> The parties submitted these matters to arbitration in which BP sought approximately \$46 million for disputed title defects, and Chesapeake sought approximately \$22 million for disputed title benefits and other “credits.”<sup>412</sup> During the arbitration proceeding, BP submitted to Chesapeake a proposed final accounting statement reflecting agreed title defects of approximately \$80 million.<sup>413</sup> Chesapeake responded with an exception report reducing the \$80 million to \$58 million, a reduction of \$22 million, which represented the title benefits claimed by Chesapeake.<sup>414</sup>

The panel awarded \$11.5 million to BP in title defects, and \$3.7 million to Chesapeake in title benefits.<sup>415</sup> In its award, “the panel noted that it made no determination of whether these amounts exceeded the aggregate threshold, or whether its ruling would actually cause any money to exchange hands.”<sup>416</sup> Chesapeake disputed the panel’s jurisdiction after the entry of the first award.<sup>417</sup> After further awards were entered, Chesapeake filed a complaint in Oklahoma state court seeking to confirm and modify the panel’s initial award, and to vacate the panel’s subsequent award.<sup>418</sup> The suit was removed to federal district court, and after due proceedings, the court affirmed the panel’s awards.<sup>419</sup> The case is more interesting on the issues pertaining to arbitration, jurisdiction, and the review of an arbitration award, than with respect to issues pertaining to purchase price adjustments.

The cases noted above demonstrate the array of issues that might arise in the purchase and sale of producing oil and gas properties, particularly against the background of market conditions that might change drastically from the date on which the PSA was executed through the date of closing. As circumstances might change for a variety of reasons—pricing of commodities, conditions of producing wells, title defects discovered

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409. *Id.*

410. *Id.*

411. *Id.*

412. *Id.*

413. *Id.*

414. *Id.*

415. *Id.*

416. *Id.* at 1256–57.

417. *Id.* at 1257.

418. *Id.*

419. *Id.*

during the due diligence period, etc.—the parties turn first to the terms of the PSA to determine if closing can be delayed, enforced, or avoided depending on the perspective of the party who considers itself adversely affected by the condition.

#### CONCLUSION

Each PSA is unique to the transaction represented and its form and structure is usually dictated by the preference and experience of the party who generates the first draft. Typically, that party is the seller. Self-evidently, although the peculiarities of the transaction dictate the content of the agreement, most forms of PSA tend to have similar types of provisions that are pertinent to the assets being conveyed and purchased.

Similarly, the organization of the contract of sale, although it might vary in specifics, will tend to address similar matters. As a consequence, examining the general structure of a PSA as is typically encountered is appropriate. Thus, the Appendix sets forth the titles of the particular sections that might be encountered in a PSA. Although lacking in greater specificity, the mere listing of topics might be of benefit to the lawyer constructing a contract of sale for the disposition of producing oil and gas properties.

## APPENDIX

As mentioned above, a detailed, section-by-section analysis of a customary PSA would not be a fruitful exercise because the doctrine of “freedom of contract” suggests that “one size does not fit all.” Further, the commercial requirements and expectations of parties vary so greatly. For this reason, the words *typically* and *customarily* are so generously used in this Article. Despite the accuracy of these words, an identification of the types of clauses or provisions that typically appear in PSAs for larger transactions would be helpful and beneficial to at least prompt a party to give consideration to issues that might be addressed in that type of contract. For these reasons, the following list sets forth the types of clauses or provisions that are often encountered in a transaction of this type. Clearly, the main consideration in constructing an agreement is driven by the nature of the assets, the condition of the property, the relative sophistication and bargaining power of the parties, and the needs and abilities of each party with respect to future liability.

- Preface
- Definitions and References
  - ✓ Defined Terms
- Property to be Sold and Purchased
  - ✓ Properties
  - ✓ Excluded Properties
- Purchase Price
  - ✓ Purchase Price
  - ✓ Deposit
- Representations of Seller
  - ✓ Organization and Qualification
  - ✓ Due Authorization
  - ✓ Approvals
  - ✓ Valid, Binding, and Enforceable
  - ✓ Litigation
  - ✓ Basic Documents
  - ✓ Consents and Preferential Rights

- ✓ Royalties, etc.
- ✓ Outstanding Obligations
- Representations of Purchaser
  - ✓ Organization and Qualification
  - ✓ Due Authorization
  - ✓ Approvals
  - ✓ Valid, Binding and Enforceable
  - ✓ No Litigation
  - ✓ No Distribution
  - ✓ Knowledge and Experience
  - ✓ Opportunity to Verify Information
  - ✓ Merits and Risks of an Investment in the Properties
  - ✓ Financing
- Certain Covenants
  - ✓ Access to Records
  - ✓ Physical Inspection
  - ✓ Exculpation and Indemnification
  - ✓ Interim Operation
  - ✓ Preferential Rights and Consents
  - ✓ Insurance
  - ✓ Governmental Bonds
  - ✓ Financial Assurances
  - ✓ Notifications
  - ✓ Employment
- Due Diligence Review
  - ✓ Review By Purchaser
  - ✓ Nature of Defects
  - ✓ NRI or WI Variances
  - ✓ Liens
  - ✓ Consents
  - ✓ Environmental Matters
  - ✓ Permitted Matters and Encumbrances
  - ✓ Seller's Response to Asserted Defects

- ✓ Cure
- ✓ Postpone Closing
- ✓ Adjustment
- ✓ Resolution of Uncured Defects
- ✓ Agree Upon Adjustments
- ✓ Other Remedies
- ✓ Adjustment For Certain Uncured Defects
- ✓ NRI Variance/Proportionate Price Reductions
- ✓ Liens/Payoff Amount
  
- Dispute Resolution
  - ✓ Possible Upward Adjustments
  - ✓ Defect Dispute Resolution
  - ✓ Limitations on Adjustments
  
- Conditions Precedent to Closing Obligations
  - ✓ Conditions Precedent to Closing Obligations of Purchaser
  - ✓ Representations True and Correct
  - ✓ Compliance with Covenants and Agreements
  - ✓ Price Adjustment Limitations
  - ✓ Litigation
  - ✓ Conditions Precedent to Closing Obligations of Seller
  - ✓ Representations True and Correct
  - ✓ Compliance with Covenants and Agreements
  - ✓ Price Adjustment Limitations
  - ✓ Litigation
  
- Closing
  - ✓ Closing
  - ✓ Seller's Closing Obligations
  - ✓ Delivery of Conveyance
  - ✓ Federal and State Conveyance Forms
  - ✓ Letters in Lieu
  - ✓ Turn Over Possession
  - ✓ Transition Agreement
  - ✓ Other Agreements

- ✓ Purchaser's Closing Obligations
- ✓ Payment to Seller
- ✓ Conveyance, etc.
- ✓ Transition Agreement
- ✓ Succession by Purchaser
- ✓ Other Agreements
- ✓ Post Closing Actions
- ✓ Transfer of Files
- ✓ Operational Transition
- ✓ Notifications by Purchaser
  
- Accounting Adjustments
  - ✓ Adjustments for Revenues and Expenses
  - ✓ Initial Adjustment at Closing
  - ✓ Adjustment Post Closing
  - ✓ No Additional Adjustments
  - ✓ Imbalance Adjustments
  
- Assumption and Indemnification
  - ✓ Assumption and Indemnification By Purchaser
  - ✓ Indemnification By Seller
  - ✓ Limitation on Seller's Indemnity Obligations
  - ✓ Survival of Provisions
  - ✓ Notice of Claim
  - ✓ Cooperation by Purchaser
  
- No Commissions Owed
  
- Casualty Losses
  - ✓ Casualty Loss
  - ✓ Notices
  
- Notices
  
- Miscellaneous Matters
  - ✓ Further Assurances
  - ✓ Gas Imbalances, Make-Up Obligations



- ✓ Waiver of Consumer Rights
- ✓ Parties Bear Own Expenses/No Special Damages
- ✓ No Sales Taxes
- ✓ Entire Agreement
- ✓ Amendments, Waivers
- ✓ Choice of Law, etc.
- ✓ Time of Essence
- ✓ No Assignment
- ✓ Successors and Assigns
- ✓ No Press Releases
- ✓ Counterpart Execution, Fax Execution
- ✓ Exclusive Remedy
- ✓ Imputed Knowledge and Waiver
- ✓ References, Titles, and Construction
- ✓ Severability
- ✓ Seller's Obligations Several Not Joint
- ✓ Like Kind Exchange