Due Diligence for Oil and Gas Properties

A Home Study Course for
Continuing Professional Development

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FOREWORD

The American Association of Professional Landmen (AAPL) is committed to serving the professional development needs of today's land professional. The demands on the land professional's time and financial resources continue to grow unabated. In a continuing effort to address these demands, the AAPL is proud to introduce the second in a series of home study courses, ***Due Diligence for Oil and Gas Transactions.***

The ***Due Diligence for Oil and Gas Transactions*** home study course is presented in a casual, conversational format rather than the more formalized format of a textbook. This departure from the norm was a conscious and deliberate decision, realizing such a format might present some grammatical errors but perhaps relax the reader and increase readability. While we appreciate the most conventional method is always the safest route and departure from it tends to offend the purist in each of us, we believe this work will educate and benefit the reader. Because of that, we know the writer will have achieved his goal: easy reading and education. We hope the reader will be tolerant of our technical transgressions.

The generic terms *he, him* and *his* have been used frequently, which is, of course, to be taken as he or her, him or her, his or hers. The term *landman* has also been used several times which, according to the AAPL Bylaws, is also generic. These decisions were certainly not made with the intention of offending the female gender, but to keep with the relaxed format.

For the same reason, the terms *landman* and *land professional* have been used interchangeably even though that practice is no longer technically proper.

This home study course will benefit all land professionals by giving them a thorough understanding of due diligence in the purchase and sale of oil and gas properties and the significant role land professionals can have in the due diligence process. In addition, Registered Land Professionals (RLPs) will earn 10 continuing education credits and Certified Professional Landmen (CPLs) will earn 10 recertification credits upon the successful completion of the requirements found in the back of this home study course within the allotted time frame.

Our thanks to Tom Burdette, Bill Dukes and Peggy Kerr for their editing and administrative assistance.

Robin A. Forte', CPL
Fort Worth, TX
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PREFACE

The land professional has traditionally performed tasks that could be broadly described as the acquisition, development and management of individual properties. He has been involved in matters such as title work, lease purchasing, negotiation and preparation of contracts such as operating agreements, farmout agreements, surface damage agreements, lease administration and the one thousand and one other things that are involved in the drilling and management of wells.

The oil and gas business has changed radically in the last decade. Many companies have fallen on hard times. Others have decided to concentrate their efforts in certain areas or have even decided to curtail their efforts in the continental United States. Fewer wells are being drilled than in the past. Many properties are being offered for sale, often at attractive prices. A number of companies are increasing reserves by purchasing producing properties instead of conducting exploratory drilling operations. These factors have led to a large number of sales transactions.

A land professional must learn new skills if he wishes to practice in this relatively new field. In the traditional landman's role, your skills were used to ensure the quality of title to properties as they were being developed. In the acquisition process, you will be applying your knowledge of land work to analyze and report the status of title to existing properties. These new skills are actually new ways of using your existing skills to determine what needs to be done in a sales transaction and how to do it in an orderly and efficient manner.

This course is intended to acquaint the land professional with the basic aspects of the acquisition and divestment of oil and gas properties. It is a nuts and bolts, how-to-do-it course. The seller's preparation for a sale, the buyer's preparation for a sale and the negotiation of the purchase and sale contract will be briefly discussed, but the bulk of the course will be devoted to learning how to plan and conduct a due diligence search. There are several reasons for this.

The majority of you will probably be involved in the actual due diligence search because that comprises most of the land work to be done in a sales transaction. The other topics mentioned above involve specialized matters such as financial, tax, securities, environmental, regulatory, geological and engineering considerations, which are beyond the scope of this course. It would require separate courses, plus study and experience, to gain expertise in these areas. The materials listed in the bibliography will provide you with further information on such subjects. However, you should be cautious if you venture into specialized areas in which you do not have a great deal of knowledge and experience. There may be pitfalls which you will not recognize.

The object has been to design a course that will be useful not only to land professionals but also to management and administrative personnel, lease record analysts, division order analysts, attorneys, paralegals and other persons who, regardless of their job titles, have been

called upon to participate in the land and title aspects of acquisition and divestment. However, it has been assumed that the student has the basic knowledge and skills one expects when one uses the term landman or land professional. The fact that some landmen have more in-house experience and some have more field experience has been taken into account. Another goal has been to create a work that will be useful as both a course textbook and a reference work.

Laws and procedures vary from state to state. The first differences you will probably think of are laws directly affecting the chain of title such as the laws of conveyancing and inheritance. However, there are many other matters that vary from state to state such as taxation, conservation rules and regulations, even the places and manner in which official records are kept and whether their contents are of constructive notice. It is literally impossible to cover the laws and procedures of all the oil and gas producing states, so you should be aware that some of the material herein may not be applicable in a given state. Similarly, there may be matters that must be considered in a given state that are not covered herein. Therefore, if you are not familiar with the laws of the state where the property is located, you should associate yourself with someone who is familiar with the law of the state when planning and conducting a sales transaction.

As you proceed through the course, you should remember that no attempt has been made to promulgate a set of rules that must be followed in every project. Each transaction has its own unique aspects, so it is impossible to write a cookbook that will cover every situation. The object has been to anticipate many of the situations you may encounter and to suggest ways in which to cope with them. Some of the procedures that are described may not be appropriate for a particular project or may constitute overkill. The intent has been to provide you with a foundation on which to build when working on acquisition and divestment. Ingenuity and initiative are important factors in this area. After you complete the course, you should have the knowledge to design and implement procedures that are appropriate to your particular project.

CHAPTER ONE

GENERAL PRINCIPLES OF ACQUISITION AND DIVESTMENT

Seven basic steps or phases are common to most purchase and sale transactions. All parties go through these steps even if they do not formally recognize them as such. They are:

1. Seller's preparation for a sale
2. Buyer's preparation for a sale
3. Negotiation of the purchase and sale agreement
4. Due diligence search
5. Pre-closing
6. Closing
7. Post-closing

You can easily picture the steps in your mind if you analogize them to the steps involved in the familiar everyday transaction of buying and selling a used car. It provides a simple example which illustrates the procedures involved in each step. Each of the steps will be covered in detail in later chapters.

Seller's Preparation For a Sale

The seller decides he wants to sell his car. He may have one or many reasons. He may need the cash. Maybe he financed it and is having difficulty making the payments. He may want to sell it and use the money to buy another car. He may be moving across the country and can't take it with him.

He evaluates it, decides what price he wants and advertises it for sale in the newspaper (after adding a little to his bottom line to allow for negotiation with potential buyers).

He prepares the car for sale by cleaning it, touching it up and doing all those little things that make it more presentable and desirable.

Buyer's Preparation For a Sale

The potential buyer sees the advertisement in the paper and decides he is interested in the car. He may have been looking for just such a car or he may have seen the ad and decided it would be an acceptable deal at the right price. He decides on the price he is willing to offer if the car is in good shape and makes an appointment to see the car. He looks the car over, test drives it and decides on an acceptable price.

Negotiation of the Purchase and Sale Agreement

The parties now enter into serious negotiations. In an effort to drive the price down, the potential buyer points out all the bad points of the car. In an effort to keep the price up, the seller points out all the good points of the car. The parties enter into an agreement whereby the

buyer will pay a certain price but has the right to have the car inspected by his mechanic. If the mechanic finds certain defects, the price will be adjusted. However, if the cost of correcting the defects exceeds a certain amount or if the defects cannot be reasonably repaired, the deal is off. The car is to be sold free and clear of any liens. The seller will give the buyer a written warranty against certain defects for a given period of time.

Due Diligence Search

The buyer takes the car to his mechanic for inspection. The mechanic finds a few defects. The buyer checks the county records and finds a financing statement filed against the car. He reports all of this to the seller.

Pre-Closing

The buyer and seller make the appropriate price adjustment for the defects found by the buyer's mechanic. They agree to close the transaction at the bank that holds the security interest in the car, where the seller will pay off the indebtedness at closing with part of the money he is receiving from the buyer.

Closing

They meet at the bank. The buyer delivers the consideration, the bank delivers a release of the financing statement and the seller delivers the car title. The seller gives the buyer the written warranty against the specific future defects covered by their agreement.

Post-Closing

The buyer secures insurance coverage and records the title and the release of the financing statement with the appropriate state agencies. The seller cancels his insurance policy on the car. The transaction is complete unless there is some future claim against the seller's specific warranty.

Problems Arising From Small Versus Massive Projects

Our example of buying and selling a used car is a very simple transaction that involves only one piece of property and very little inspection and examination. An oil and gas transaction may be a small project that involves the sale of only a few wells or a massive project that involves hundreds of properties.

Time and money are important considerations to the client. By time, we mean the time it takes to get a title report in his hands and to close the transaction. Money is also related to time because fees for land services are generally charged on a time basis and not on a per job basis. The client is generally willing to expend more time and money on a large project than a small one. It is only human nature for him to expect a small project to be accomplished very rapidly at very little cost. However, he needs the same information in either instance if he is to make an informed decision as to whether to purchase the properties. The only real difference is in the magnitude of the undertaking.

A thorough due diligence examination is the same for a project of any size. For example, compare the preparation of an ownership report for a downtown city block with one for a small lot in a subdivision. The same type of work with the same amount of care must be

performed for both. The differentiating factor is that title to the downtown city block will be more complicated so it will take a greater amount of work with a corresponding time delay in getting the report to the client. Similarly, the differentiating factor in conducting a due diligence examination for a large project is that because it involves more properties, it requires more work, thus requiring more people and time to accomplish it. Planning and timing are greater factors in a large project so time must be allocated to management and administration in addition to performing the actual examination.

The same is true for the other steps involved in the purchase and sale transaction. It is easier to negotiate and draft a contract for the sale of one well than a contract for the sale of one hundred wells but most of the same factors must be considered. It just takes more time and work to provide for the larger number of possibilities introduced by the larger number of properties. If for no other reason, it is easier to conduct the closing of a small transaction than the closing of a massive transaction because there are fewer pieces of paper to shuffle.

The small project is a ticklish area for the land professional. The same considerations, obligations and liabilities apply to him regardless of the number of wells. He must exercise the same amount of care and expertise for a one well project as he does for a one hundred well project, even though the client expects it to be done very quickly and cheaply.

The only solution to this quandary is for the land professional to carefully explain to the client the matters that must be covered in order for the client to be sufficiently informed and protected in a purchase and sale transaction. He must establish ground rules with the client as to the extent of the examination and the matters for which they will be responsible. The usual report to a client shows the material examined. In the case of a limited examination, the land professional should take care to recite the material that at the client's request was not examined.

CHAPTER TWO

PREPARATION FOR A SALE

The preparation for a sale will be discussed in the following three chapters which cover the seller's preparation for a sale, the buyer's preparation for a purchase and the purchase and sale agreement. In those chapters, you will be briefly acquainted with some of the mechanics of selecting and advertising properties for sale, evaluating the advertised properties and the basic contents of a letter of intent and a purchase and sale agreement. As noted in the preface, these topics have not been covered in greater depth because they often require expertise in specialized areas that are beyond the scope of this course.

You may notice the terms *offering* the properties for sale and *accepting* the offer have been avoided in the chapters on preparation for a sale. Offer and acceptance are technical legal terms. If you make an offer to sell, the acceptance of the offer by another party can constitute a legally binding contract to sell and purchase if the terms of the offer are sufficient to define the necessary terms of the transaction. (Most offers and acceptances in transactions such as those we are discussing must be in writing.) As a simple example, if the seller offers to sell his interest in a well for a million dollars and the buyer accepts the offer, that is it. They have entered into a contract. Neither party will be able to impose further conditions such as obligations to be assumed by the buyer or the quality of the title to be conveyed by the seller.

In preparation for a sale, the parties do not wish to be bound by a contract to purchase and sell. The seller merely wishes to advertise and show his properties to interested and qualified buyers and to state the general terms under which he would entertain an offer to purchase them. The buyer merely wishes to review the properties to determine whether he is interested in purchasing them and, if he is interested, make a bid stating the terms under which he would be willing to purchase them. Technically, the buyer's bid is an offer to purchase which is subject to acceptance by the seller but it will usually contain language that makes it subject to negotiation of further details by the parties. If the parties wish to pursue the matter further, they will enter into negotiations for a formal purchase and sale agreement.

Preparation for a sale is an exercise in both economics and philosophy. The parties must consider the economic effects of the transaction on their respective operations. They must also consider the manner in which the transaction will affect the positions and long term objectives of their companies. The seller has already evaluated the effects of the sale because he initiated it in an attempt to accomplish a planned goal. For the buyer, the sudden opportunity to purchase a group of properties means that he must quickly determine both the economic effects of such a purchase and its effects on the purpose and direction of his company.

Chapter Four covers the basic contents of a letter of mutual intent and a formal purchase and sale agreement. This chapter has been designed to acquaint the student with some of the matters that should be covered in these documents although it by no means constitutes an

exhaustive treatment of the subject. In addition, every such contract should be tailored to fit the circumstances of the particular transaction. A basic form of a purchase and sale agreement has been included in the appendix as an example. Several excellent works on the subject are listed in the bibliography.

These discussions have been primarily directed toward large sales although the same general principles apply to both small and large sales. The main difference is that some of the matters covered, while still applicable, may constitute overkill in a small sale.

CHAPTER THREE

THE SELLER'S PREPARATION FOR A SALE

Obviously, the first step in the seller's preparation for a sale is the selection of the properties he wishes to sell. In order to do this, he must define his strategic objectives and identify the properties he should sell (divest) in order to meet these objectives. He must consider both his short term objectives and his long term objectives. In other words, he must determine his present position, the position he wishes to occupy in the near future and his long term goals. He can then evaluate his properties to determine which ones he should divest in order to change his present position and meet his objectives.

The seller may have many reasons to divest properties. He may be in financial difficulty and needs to sell assets to raise cash. He may be in a position where, although certain properties show future promise, he cannot afford to properly operate or further develop them. He may desire to sell the properties to raise cash for the operation and development of other properties. He may wish to change the emphasis of his operations from oil to gas or gas to oil or from one geographic area to another. He may have decided it is not economical for him to operate a given property. A diversified company may simply wish to leave the oil and gas exploration and production business.

Once the seller has determined he wishes to divest part of his assets, he must devise a set of selection criteria to identify the properties that should be sold. One factor is the return on investment. He should examine his various properties with regard to matters such as cash flow versus administrative overhead. (In this limited discussion, the term administrative overhead is used liberally to mean every cost of operating the property from actual expenditures on a well to office administrative costs.) Such factors can vary with both the nature of the property and the size of the company.

One popular theory is the "80/20" theory, which states that 80% of a company's oil and gas properties may generate only about 20% of total cash flow. It is by no means a cast iron rule but rather a reminder that when evaluating your properties, you will probably find that a small proportion of your properties contributes a large amount of income. Therefore, one thing to look for when analyzing potential sale properties is their relative contribution to income.

There are numerous actual out-of-pocket cost factors that should be considered. Some properties may be far from the majority of the seller's other operations, leading to the extra cost of either sending employees a long distance to perform work on the wells or hiring outside contractors to do work. In either case, supervisory personnel must periodically make trips to the properties. A property may simply be inefficient to operate, such as one that generates a high proportion of salt water that must be disposed of, requires costly pumping to produce a small amount of oil or has antiquated equipment with high maintenance costs. A side benefit of this analysis may be the identification of wells that should be plugged if they are not sold.

The size of the seller can be a factor in the advisability of divesting a property. In general, a large company has more levels of managerial, supervisory and administrative personnel than a small company. A small company with fewer such employees may be able to operate a given property at a reasonable profit whereas a larger company cannot. The larger company is inherently geared to large operations. Therefore, a large company wishing to divest properties should identify those that are relatively inefficient for it to operate but which might be attractive to smaller companies.

The seller should consider whether it is advisable to sell the properties in one package or whether it is more desirable to advertise them in several packages based upon factors such as geographical areas, the nature of the properties and the availability of buyers for the various properties. In a large sale, there may be so much money involved it may be difficult to attract buyers capable of purchasing the entire package. Another factor to consider is time. Depending upon the circumstances, it may be quicker to sell the properties in one manner or another.

One alternative is to divide the properties into separate packages and give potential buyers the opportunity to bid on the packages with the understanding if there is a higher bid for all of the properties, it will be accepted by the seller. Another alternative is to advertise the properties as one package with the understanding the seller will consider bids on separate portions if warranted by market conditions. These alternatives should be approached with caution because they can deter buyers who fear that even if they go to the trouble and expense of evaluating and making a bid on one package, they may be outbid by another purchaser who is bidding in a different manner. They can also engender hard feelings between the seller, the bidder on one package and the eventual successful bidder.

The seller must determine the value it will place on the properties. Many companies, especially those whose stock is traded on the open market, regularly engage outside engineering firms to evaluate their reserves. If so, the seller will have a relatively current independent valuation of its oil and gas properties. There are many formulas for determining an asking price for oil and gas properties. One formula some use is present worth or present value (pv) as determined by the independent consultant, discounted for time at 10-25 percent. Depending on the circumstances, another method of determining an asking price for producing properties is cash flow for the last two to four years. You should be aware these formulas are presented merely for informational purposes and not as firm rules. The seller should be sure its total evaluation includes the values of well equipment and other tangible assets in addition to the value of oil and gas reserves. Of course, liabilities such as plugging and reclamation costs must be considered.

It should be noted the present worth of the properties as determined by an independent consultant may or may not agree with the company book value. That is because the independent valuation is based upon the present and assumed future market value of the properties whereas book value is based upon purchase price and investment less depreciation. Therefore, the company book value may either be higher or lower than the present worth as determined by the outside consultants.

It is possible both the seller and potential buyer will utilize evaluations by the same outside engineering firm, especially if the seller is a publicly traded company that must have its assets periodically evaluated by a recognized firm. The buyer may be willing to accept an evaluation by the same firm based upon its reputation for thorough and unbiased analysis. If it has been some time since the latest evaluation, the potential buyer may wish to secure an updated evaluation. Of course, the seller and potential buyer must agree that the buyer can utilize the services of the same firm in order to free the evaluating firm from charges of conflict of interest.

Unless there is an explainable difference, the asking price should be based to a large extent on the value assessed by reliable consultants rather than the book value. A potential buyer will probably engage an independent engineering company, possibly the same company that evaluated the properties for the seller, to evaluate the properties. Given the same data and the same methods of analysis, both companies may come up with similar evaluations. Therefore, an asking price based upon a reliable engineering evaluation will probably be more acceptable to a potential buyer. However, the seller should be aware of potential problems or questions resulting from a sale made at a significant differential from book value. Stockholders, investors and possibly the Internal Revenue Service may wish to inquire about such differences.

After you have identified the properties you wish to sell, the next step is to get the word out that you wish to sell the properties. Your first thought may be to advertise the properties for sale in newspapers and trade publications but the way most sales seem to be advertised is through word of mouth in professional and industry networks. Parties in the business are always watching what the other does, listening for gossip and approaching each other as to whether the other party would be interested in selling or buying properties. Contacts may also be made through commercial companies such as financial consultants who specialize in assisting buyers and sellers of oil and gas properties. Newspaper articles reporting that a company intends to put up properties for sale usually appear long after the word is out on the street. Therefore, if you wish to sell oil and gas properties, the most effective route may be to start telling potentially interested parties you are considering a sale or, in the event of a large sale, engage the services of a commercial company.

One other method of selling properties not covered here is the auction sale. Such sales are usually conducted by professional auction companies. Advertising is handled by the auction company and properties are typically sold on an "as is, where is" basis without an inspection of the seller's internal records. If you are interested in selling properties at such a sale, the auction company will provide information on its procedures and requirements.

Many companies will establish a divestment committee or team to handle property sales. Such committees may be composed of land professionals, attorneys, geologists, engineers, management, financial or other personnel who have the combined talents to evaluate and structure a proposed sale. It is quite common, especially in the instance of a large sale, for both seller and buyer to engage the services of companies which specialize in advising their clients on the advisability and the manner of structuring a purchase and sale. These are the consulting companies we mentioned above in connection with advertising. This not only

provides the parties with the expertise of outside consultants but also serves as a buffer or shield in case the sale is later contested by disgruntled stockholders or investors.

There are several additional advantages in employing a consultant. As they are regularly engaged in the business of acquisition and divestment, they will be able to advise the seller on matters such as the identity of potential bidders and the best manner in which to package the properties to attract bids. The consultant will probably also be aware of matters such as the general financial status of potential bidders, their ability to close a transaction and their track record for actually making purchases.

After the seller identifies and evaluates the properties it wishes to sell, it should prepare a bid package (an invitation to bid) for submission to potential buyers. The bid package may be sent both to parties who have already expressed some interest in the properties and other parties the seller believes may be interested in the properties.

To digress for a moment, at some time in the process the seller should establish criteria for identifying serious, qualified and desirable bidders. The criteria should enable the buyer to avoid parties such as "tire kickers" who are not serious about bidding and may be only seeking information about the properties or the seller's interests in them, parties who are not financially able to complete the transaction and parties with an undesirable reputation in matters such as being difficult to deal with or for failing to close transactions. One criterion a seller often establishes is that it will deal only with principals and not with agents. Not only are direct negotiations faster and easier to conduct but this avoids possible misunderstandings in the transmission of information between the parties.

The decision to avoid dealing with certain parties may be made before bid packages are sent out or after responses are received from the potential bidders. The seller may simply decide not to send a bid package to a given party, not to invite the party to examine the information in the data room or to reject a bid made by a party with whom the seller does not wish to deal. Of course, the seller should make it clear in the bid package that it reserves the right to reject any and all bids for reasons satisfactory only to itself. The seller should also make it clear that acceptance of a bid is only an agreement to enter into negotiations for a formal purchase and sale agreement and not an acceptance of an offer to purchase.

The bid package should contain sufficient information to enable a prospective bidder to decide whether it is interested in the properties. The following are examples of items that might be included in a typical bid package:

1. Cover letter.
2. Confidentiality agreement.
3. Seller's proposed form of purchase and sale agreement.
4. Lists describing the properties being offered for sale.

Cover Letter

A cover letter provides general information on the properties being advertised for sale, precautionary statements such as advisories that the seller reserves the right to determine what

are qualified bids and who are qualified bidders, the timetable the seller wishes to follow in receiving bids, evaluating the bids and the bidders, executing a letter of intent, executing a formal purchase and sale agreement and closing of the transaction. Such a letter will also contain information as to how the properties may be broken up into separate packages and the procedures for bidding on separate packages. The seller may specify a minimum bid offer or otherwise indicate the minimum size of a bid that it will consider. The seller may also ask interested parties to submit financial and other pertinent information on their companies for its use in determining the qualifications of prospective bidders.

Confidentiality Agreement

A confidentiality agreement to be executed by the bidder is essential because the seller will be allowing the bidder to examine all of its technical and financial information on the properties. A sample form is shown in the appendix.

Seller's Proposed Form of Purchase and Sale Agreement

The cover letter will probably contain a statement to the effect the seller believes the terms of its proposed agreement are reasonable and equitable and it will look unfavorably upon significant changes proposed by bidders.

Lists Describing the Properties Being Offered for Sale

Lists describing the properties being offered for sale will include information on the nature of each interest such as whether it is a fee simple interest, working interest or overriding royalty interest, sizes of the interests, production histories, estimated reserves, etc. In essence, these lists contain a sample of the information that will be available for further examination in the seller's data room.

The seller may establish a data room which contains all of the detailed technical and financial information a prospective buyer will need to evaluate the properties and prepare an informed bid to buy them. The data room will literally contain all of the information the seller possesses on the properties except detailed land title information. If the properties have been divided into packages, the seller may establish a separate data room for each package. If there are many prospective bidders or if time is pressing, the seller may establish duplicate data rooms so more than one prospective bidder can examine the material at the same time. This can be an expensive proposition because it involves duplicating everything in the original data room.

The seller is trying to induce buyers not only to buy his properties but also to buy them at the highest price he can obtain. Therefore, it is in his interest to show them in their best light. The data should be presented in a usable and organized manner and all visitors should be treated congenially and hospitably. As in the example of the seller of the used car, he wants to make his merchandise look as desirable as possible and assure prospective buyers they will receive good cooperation if they are the successful bidders. He should make his sales pitch in the best possible manner. However, he must enable the bidders to see the negative as well as positive information. Otherwise, the entire transaction could fail on the grounds of bad faith.

By this time, the seller will have determined the preliminary qualifications of parties who responded to its invitation to bid. The seller will invite those parties it has determined to

be qualified buyers to examine the information in the data room (ordinarily one at a time) and submit formal bids based upon their examination.

After the prospective buyers have submitted their bids, unless one bid is not only acceptable but definitely superior to all of the others, the seller may select the best bidders and invite them to further examine the material in the data room and to submit revised bids. At this point, the seller may conduct preliminary negotiations with these bidders, pointing out matters it would like to see included or omitted from their bids or further discussing the sales price. For the sake of time, the seller may set up duplicate data rooms if he did not do so in the beginning.

When the seller has selected a bidder, he will then invite the bidder to join in a letter of intent to purchase and sell the properties. The discussion of this process will be continued in Chapter Five.

CHAPTER FOUR

THE BUYER'S PREPARATION FOR A SALE

The buyer's preparation for a sale in response to an advertisement by a seller involves essentially the same matters described in Chapter Three. The primary difference is in the viewpoint of the parties; therefore, this chapter will not repeat many of the details presented in that chapter. The main thrust of this chapter will be to present the topics from the buyer's point of view. However, one additional matter that will be mentioned is the situation where the buyer is seeking to purchase properties that have not been advertised for sale by their owner.

The seller has one major advantage in an advertised sale. Unless for some reason he is conducting a sale on short notice, he has had ample time to select the properties he wishes to sell, evaluate them and structure the manner in which he wishes to conduct the transaction. On the other hand, the buyer may be viewed as reacting rather than acting. Unless the bidder has some source of prior knowledge such as ownership in the same properties, he may not have an opportunity to evaluate ownership, technical and financial information until he receives the bid package. From that point on, he must work as quickly as possible in his evaluation of the properties and the preparation of his bid because he is faced with the seller's time limits and competition from other potential buyers.

Many companies establish acquisition committees or teams to handle property purchases just as selling companies establish divestment committees. The composition of both acquisition and divestment committees is essentially the same because they are performing the same tasks. The primary difference is that an acquisition committee is evaluating and structuring transactions from a buyer's point of view whereas a divestment committee is doing the same thing from a seller's standpoint, the main difference being in perspective. The seller, in order to justify a high prices, assumes good things in the future while the buyer, to secure a good investment, is more pessimistic. In the instance of a large purchase, the buyer may also engage the services of a financial consultant to advise it on the advisability and manner of structuring the transaction.

The buyer may learn of a pending sale through advertisements, word of mouth or receipt of a bid package from a seller. If the buyer decides he may be interested in the properties, he must evaluate his present position and strategic objectives and make a preliminary determination as to whether the purchase of the properties will help achieve his short term and long term goals. One of the buyer's first objectives will be to identify the properties, the size and nature of the seller's interests and determine whether they are of interest to him. He should make a preliminary estimate as to the costs of acquisition. He should consider matters such as how the properties can be merged into current operations, the increased number of personnel and any additional equipment needed to operate and administer the properties and whether his financial status will allow him to acquire and properly operate them. If additional funds will be required to purchase them, he must

determine the manner in which he will acquire the funds. He may consider options such as entering into a joint effort with others to purchase the property. In short, the buyer should perform a preliminary analysis that is sufficient to allow him to decide whether or not to further pursue the matter.

If the buyer's preliminary evaluation indicates a purchase would be of interest to him, he should secure a copy of the seller's bid package and examine it from several aspects. He should review the documents to ascertain that the general terms of sale advertised by the seller are either acceptable or the unacceptable terms are relatively minor in importance and are of the nature he believes can be changed through negotiation with the seller. He should review the seller's proposed confidentiality agreement to make sure it will not inhibit the buyer's present or future operations. In fact, at this point, the buyer may wish to contact the seller to find out whether the seller would be amenable to the changes desired.

The buyer should review the descriptions of the properties listed in the bid package to determine whether they are located in areas of interest as well as other matters that may be of importance such as the producing formations or the mix of oil and gas wells. The bid package may also provide production histories for the properties. If there are properties listed that are not of interest, he must determine what disposition can be made of these properties if acquired. At this point, the buyer may begin sending out feelers of his own to companies that might be interested in subsequently buying the properties in which he has no interest.

The ownership, technical and financial information in the package should be thoroughly analyzed in order to determine the quality of the properties and an approximate price the buyer would be willing to pay for them.

If the buyer's analysis of the information in the bid package indicates a purchase would be feasible, desirable and commensurate with his long term goals, the next step is to contact the seller and make arrangements to examine the material in the seller's data room. The buyer will make his final decision whether or not to submit a bid on the properties, how much to bid and the terms of the bid based upon his analysis of the information in the data room.

The buyer should be very careful to recite in the bid that he is making an offer to enter into negotiations leading to a definitive purchase and sale agreement and that the bid is not an offer to purchase the properties.

As discussed in the preceding chapter, the seller may select the best bidders and invite them to revisit the data room and submit revised bids. Some negotiation may take place between the seller and buyer at this point in order to create a bid that is acceptable to both parties. After the seller has selected a bidder, the bidder will be invited to join the seller in a letter of intent to purchase and sell the properties. The discussion of this process will be continued in Chapter Five.

This discussion has covered the situation where the seller has made a decision to divest the properties, evaluated the properties and advertised them for sale. As a part of the process, he has made a great deal of information on the properties available to potential buyers. The

opposite situation exists where a buyer wishes to purchase properties that have not been advertised for sale. Unless the buyer wishes to alert the owner and third parties to his interest in the property by asking for detailed information, he is limited to information he can glean from public records and commercial information companies. It can be very difficult to evaluate the properties under these circumstances. However, if the buyer is a co-owner in the properties, he may already have a great deal of information in his files in the form of division order title opinions, division orders, operating agreements and the like.

The unsolicited buyer may be forced to make a preliminary offer based on a very limited amount of data. Therefore, he should couch the preliminary offer in very broad terms and make it very clear that it is not an offer to purchase but merely an inquiry as to whether the seller would like to enter into negotiations for a sale.

CHAPTER FIVE

THE PURCHASE AND SALE AGREEMENT

After the seller has selected the party he believes to be the best bidder, he will invite the bidder to enter into a letter of mutual intent for the purchase and sale of the properties. The parties do not ordinarily intend the letter of intent to be an enforceable contract but rather an agreement to agree. It is essentially an agreement to enter into negotiations for a definitive purchase and sale agreement. In attorney parlance, it is full of "weasel words" which keep it from becoming a binding contract. The author took the following example of such wording from an actual letter of intent:

> The parties agree that this letter of intent shall not constitute an agreement of purchase and sale and that neither party will have an obligation to consummate a purchase or sale of the assets except in accordance with a mutually acceptable definitive written purchase and sale agreement. Other material issues including, without limitation, representations, warranties and indemnities, shall be addressed in the purchase and sale agreement to be negotiated by the parties. Buyer has reviewed Seller's draft purchase and sale agreement and agrees that said draft may be used as a point for commencing negotiations, provided, however, that neither party is or shall be bound by any terms which are not contained in a purchase and sale agreement executed by each of the parties hereto and there shall be no presumption that the parties have agreed to the terms of Seller's draft purchase and sale agreement.

You should not ascribe any evil or nefarious connotations to the use of the term "weasel words." Although it sounds harsh, it is simply a commonly used slang term for language in a document that allows one or both parties to withdraw or change their position if certain conditions are not met. Another term is "escape clause" which doesn't sound much better. In the context of a letter of intent, weasel words are used to make it clear that neither party intends to be bound to a purchase and sale transaction until the terms of the transaction are defined in a mutually satisfactory written contract.

The letter will state the anticipated purchase price, identify the properties and the seller's interests in them and outline some of the general terms of the transaction. The description of the properties will probably contain appropriate language to the effect that they are a recitation of what the seller believes his interests to be and are subject to correction. The seller will probably agree that pending execution of the purchase and sale agreement or the termination of negotiations, it will not offer the properties for sale to others. The buyer will probably agree to extend its confidentiality agreement with respect to the properties to the time of closing. The parties may agree to other matters such as not disclosing the transaction or the identity of the other party without first obtaining the written permission of the other party.

The letter will often establish target critical dates such as an effective date for the sale, the date for approvals of the transaction by the boards of directors of the buyer and the seller, the date for execution of a purchase and sale agreement, the closing date and any other dates that may be important in the transaction. The purpose of including the target dates is to establish the time table the parties expect to follow in the transaction.

Even though the parties have not entered into a binding purchase and sale agreement, in the interest of time the letter of intent may allow the buyer to commence its due diligence examination and other efforts upon execution of the letter.

The letter of intent may also be accompanied by a down payment or good faith deposit from the buyer to either be deposited with the seller or with a third party under a written escrow agreement. If not, the letter will usually provide for a down payment to be submitted by the buyer upon execution of the purchase and sale agreement. If a good faith deposit is made upon execution of the letter of intent, provisions must be made for its disposition if negotiations break down. Such provisions can be difficult to draft unless they provide for simple situations such as retention of the good faith deposit by the seller if the buyer does not enter into a contract or for return to the buyer if the seller does not enter into a contract. Even then, such provisions can lead to controversy because each party may point its finger at the other and allege that it was ready to enter into an agreement but the other party made unreasonable demands.

You should be very careful when including specific provisions in a letter of intent. If the letter of intent contains provisions sufficient to define the complete transaction, it could be held to form a contract even if it contains weasel words such as those quoted above. Therefore, you should draft the letter in a manner which will reflect the general expectations of the parties but will not bind them to the transaction. To put it bluntly, you are not only concerned with what the parties think the letter says but what a court of law will say it says in case of a controversy.

Two fine points for consideration are whether the execution of a mutual letter of intent obligates the parties to conduct good faith negotiations even if the letter does not specifically use the words "good faith" and what exactly constitutes good faith negotiations. These questions are difficult to answer and the results will probably depend on the behavior of the parties on a case by case basis.

For a narrative of the nightmares that can arise out of preliminary agreements (both signed and unsigned) and oral discussions, you should read *Oil and Honor, The Texaco-Pennzoil Wars* by Thomas Petzinger, Jr. (New York, G.P. Putnam's Sons, 1987). In this book, the author recounts the controversies that arose between Pennzoil Company and Texaco Inc. over the purchase of Getty Oil Company. The primary questions were whether Pennzoil's negotiations and preliminary agreements with Getty and some of Getty's largest shareholders created a legally sufficient purchase and sale agreement and, if so, whether the subsequent sale to Texaco violated or interfered with the agreement. The intricacies of the case are too extensive to relate here but it serves as a textbook example of pitfalls to avoid when negotiating a purchase or sale. The Pennzoil case has caused parties to exercise great care when negotiating mergers and acquisitions.

The parties will now enter into negotiation of the provisions of the purchase and sale agreement, the contract under which the properties will be bought and sold. It is often referred to in business jargon as the "definitive purchase and sale agreement" or "definitive agreement" because it defines all of the terms of the transaction and the respective rights and obligations of the parties. The word definitive ordinarily has no special meaning because a contract implicitly contains all of the terms of the agreement. "Final agreement" might have been a better choice of terms but jargon arises through usage, not from the rules of grammar or legal niceties.

The parties will typically use a draft form prepared by one of them as a starting point. As noted previously, the seller often includes a proposed form as part of its bid package and will strongly urge it be used as a foundation. We have included such a form in the appendix. It was included in a bid package and used by the parties as a starting point for negotiations. The transaction was large, complex and covered properties in several states so by the time the parties finished negotiating the final contract it was three or four times as long as the example.

Do not simply take such a generic form and begin filling in the blanks. You should first review the form to see whether it covers matters of importance to you, whether it contains provisions that are objectionable to you and whether it covers all of the circumstances that may arise in your particular transaction. Make sure all of the provisions of the sale are included in the written agreement. If not, misunderstandings can arise and something you thought would be done by the other party will not be legally enforceable. Also, even if the parties rely upon verbal agreements to confirm the written contract and are willing to abide by them, the persons who made the verbal agreements may not be available at the time specific questions arise. In general, the attitude of the law is that written contracts constitute the entire agreement between the parties and can only be modified in writing. The parties often formalize this by including a clause to that effect.

The following discussion covers some of the matters that should be taken into consideration when negotiating a purchase and sale agreement. It is impossible to list all of the matters that may appear in different transactions so do not look upon it as all inclusive. You should look upon it as a discussion of the highlights that are common to many sales and remember to provide for matters that are applicable to your particular transaction. Also, there are many factors such as the tax and financial structuring of a transaction that are beyond the scope of this course. The discussion may address more matters of interest to buyers than to sellers but that is simply because the buyer is buying properties that are unfamiliar to him and wants all the protection he can get. Several works on purchase and sale agreements are listed in the bibliography, some of which also contain sample agreements.

One other matter that should be considered but which is beyond the scope of this course is the situation when the seller is in financial straits and may be forced into bankruptcy by its creditors. The buyer should have done enough investigation to know whether such an action might be brought prior to closing. In that event, he will want to negotiate not only with the seller but also with the seller's major creditors. Another situation is when it is possible the seller may be forced into bankruptcy after the sale has been closed. The law allows a bankruptcy court to look back in time and to determine whether a sale by the debtor was fair, reasonable

and made for sufficient consideration. If there is the slightest hint the seller might be in financial trouble it would be prudent for the buyer to secure the advice of bankruptcy counsel in structuring and documenting the transaction.

The following topics are not necessarily covered in the order in which they would appear in a purchase and sale agreement and the order in which they are presented has no bearing on their relative importance. Your should maintain the attitude that every part of the agreement is important. The topics have been presented in an order that will allow the reader to see some of the relationships between the various provisions.

One of the first things that appears in the agreement is the identity of the signatory parties. The seller's names should include all of the names in which the seller holds title and all parties who hold interests that would make them necessary parties to a conveyance. As an example, a lender might not hold what you would think of as an ownership interest in the properties but its mortgage might entitle it to a participating ownership in the premises upon a sale with the right to approve the sale. The buyer's names should likewise include the names of all of the buyers. If there is more than one buyer, it may be desirable to state the percentages in which the respective buyers are acquiring title.

The land professional should make sure all of the selling and buying parties sign the agreement. This may seem like stating the obvious but one of the many issues in the Pennzoil case was that one of the selling parties had not signed one of the documents under which Pennzoil was claiming.

The legal names and identities of the sellers and buyers is essentially a title question which should be resolved as quickly as possible. It may be necessary to amend the agreement as the parties proceed to closing if it is discovered, for example, that title was held in a predecessor company and that record title was not merged or assigned into the present seller. If you suspect this situation may exist, you may wish to provide that the parties will amend the agreement in writing to include such additional selling parties as they are identified.

Particular situations to watch for are when the seller is selling its interest as a partnership, partner in a partnership, limited partnership, general or limited partner in a limited partnership, joint venture or joint venturer. You must not only look to the instruments establishing the entity to determine the circumstances under which it can sell its interest but also to the law of the state governing the entity and the nature of its ownership in the property in order to determine the manner in which it holds and can convey title. You should be aware that the laws of two states may be involved. One is the law of the state under which the entity was created (or exists) and the other is the law of the state where the property is located.

As an example, a joint venture is not an entity capable of holding title to real property (which for our purposes includes oil and gas leases) in Oklahoma. Title is treated as being owned in common in the owners' respective proportionate shares. Therefore, each joint venturer in Oklahoma property must join in the sale to convey his interest. As a further hazard, if a joint venturer is considered to be a tenant in common under state law, the homestead, dower or community property rights of an individual joint venturer's spouse under the

applicable state law must be taken into account and it may be necessary to have the spouse join in the purchase and sale agreement and the subsequent conveyances.

You should watch for situations such as the foregoing when you are negotiating the agreement and not rely on hope that everything will work out for the best. A recalcitrant or uncooperative spouse, partner, limited partner or joint venturer can kill the deal as to that party.

The contract may contain representations by the parties with respect to their right, power and authority to enter into the agreement and carry out its provisions. Both parties may represent they have been empowered by their respective boards of directors, partners, etc. to conduct the transaction. They may represent they are in existence and in good standing in the applicable states. The parties may represent they are the real parties in interest and are acting on their own behalf and not as representatives of others. This assurance is largely for the comfort of the seller because he wishes to know with whom he is dealing. Not only has he probably evaluated the buyer with respect to matters such as its reputation in previous transactions and its financial status but he wants the comfort of knowing that the person with whom he is dealing with has the complete ability to enter into and perform under the contract and will be bound by it.

Coupled with this is a representation that neither party owes any fees or commissions to third parties arising out of the transaction. Each party usually agrees to indemnify and hold the other party harmless for breach of this provision.

A general representation by each party that it has the full right, power and authority to enter into and perform under the agreement also serves to protect the respective parties against liability arising under claims by third parties such as claims that they had a prior right to purchase the property. The parties may wish to secure indemnification from each other to protect themselves against such third party claims.

However, you should exercise care if you draft indemnification provisions against specific circumstances. A claim of a prior agreement to purchase was the basis for the controversy between Pennzoil and Texaco. One of the factors in the case was that Texaco, the buyer, had agreed to indemnify Getty Oil and some of its largest shareholders, the sellers, against claims by Pennzoil under the prior negotiations for sale between Getty and Pennzoil. Among other things, the jury apparently considered Texaco's indemnification to be evidence of an agreement between Pennzoil and Getty.

The agreement will usually contain a statement that it will be binding upon and inure to the benefit of the parties and their respective heirs, successors and assigns but it cannot be assigned by the buyer without the express written consent of the seller. The restriction on assignment by the buyer is important to the seller because the ability of the buyer to complete the transaction is one of the factors the seller considered when entering into the contract.

The choice of law under which the contract will be interpreted is another important matter to be considered when the transaction affects parties and properties in more than one state. As a general rule, the parties are free to select the law of any state that bears some reasonable relationship to them and the property.

Another provision that should be included is that the agreement will survive closing. Without such a provision, the law considers a contract to be completed and merged into the conveyances at the time of closing. In the typical acquisition, there are still many acts to be performed after closing; therefore, this provision is a necessity.

It will also be necessary to define the time at which possession of the properties will be transferred and upon which party the risk of loss from casualty will fall prior to closing or actual transfer of possession. Normally, the buyer is entitled to possession at the time of closing and risk of loss will be transferred at that time.

The time and method of transfer of items such as books and records should also be provided for. It will probably be necessary for the seller to continue to handle financial matters such as distribution of well proceeds and payment of ongoing expenses until the buyer can incorporate the properties into his accounting system. The seller will also want to have continuing access to the records for matters such as tax reporting.

Other matters that should be covered in the agreement are environmental matters and the right to make FERC elections, both of which are important but are beyond the scope of this course. We have provided some information on environmental matters in Chapter Eight.

The seller will make certain representations and warranties concerning its interests. The seller will not usually grant a general warranty of title to its properties but will make representations that its interests are not less than the amounts listed in the exhibits and they are subject only to permitted encumbrances of types described in the agreement and are usually listed with the descriptions of the properties on the exhibits. Typical encumbrances include agreements such as farmouts, participating or operating agreements and orders of regulatory agencies. Along this same line, the seller may make other representations regarding its ownership interests such as the oil and gas leases are in full force and effect, it is not in default under any contracts or agreements and regulatory orders are in full force and effect, etc.

The agreement should define a standard of title in which the parties agree upon the nature of matters that will constitute title deficiencies. If the property is located in a state such as Oklahoma which has an extensive set of title examination standards, the agreement might provide that no matter will be considered to be a title defect unless it constitutes a defect under the Oklahoma Bar Association Title Examination Standards. The author has seen provisions to the effect that matters commonly accepted in the ordinary course of business by reputable oil companies in the area where the property is located will not be considered to be title deficiencies. This is one method of avoiding nitpicking title objections but it is wide open to an argument as to what constitutes custom.

The seller is usually willing to grant what is known as a "limited" or "special" warranty. This is a warranty of title against claims by third parties which arise by, through or under it. The warranty should be spelled out in the agreement because the terms "limited warranty" or "special warranty" may not be defined by statute in every state.

One of the most famous clauses is the due diligence clause. The seller will agree to make its books, files and records which pertain to the property available for the buyer's inspection. The buyer will have until a given date to examine the seller's records and all applicable public records and submit written objections concerning title to the seller. The buyer will be charged with knowledge of all defects or deficiencies it could have discovered through the exercise of due diligence in its examination. The physical aspects of the property (physical condition, existence, environmental matters, etc.) may also be included in these provisions.

The provisions for the buyer's access to examine the seller's records and property should be drafted very broadly. You are not only dealing with matters such as its well sites and land files but also matters such as well records, financial and production records, environmental records and computer records of all types.

The agreement will establish what are commonly known as the critical dates including:

1. Effective date of the agreement.
   (Often, the buyer will be entitled to all proceeds attributable to the property after this date and charged with all reasonable costs attributable to the property after this date.)
2. Buyer's time to conduct its due diligence examination and submit written title objections to the seller.
3. Seller's time to cure title deficiencies and submit curative material to the buyer.
4. Buyer's time to examine the seller's title curative material.
5. Time of closing.
6. Times of any delayed closings.
7. Time of the post-closing accounting.

The agreement should contain a statement that time is of the essence so the critical dates become legal deadlines and any party not performing by such dates will be in default under the pertinent provision. If the agreement does not contain a statement that time is of the essence, a court may interpret the contract as allowing a reasonable time for performance and excuse the failure to meet a critical date.

The agreement will specify the purchase price to be paid by the buyer and the manner of payment (for example, in U.S. funds, by wire transfer at time of closing). If a down payment was not made at the time the parties executed the letter of intent, it will normally be paid at the time the purchase and sale agreement is executed, to be credited to the buyer at closing. If a down payment was made at the time of signing of the letter of intent, the seller will be given credit for it against the purchase price. Provision must be made for custody of the down payment prior to closing. It may be paid directly to the seller or it may be held by a third party under a written escrow agreement.

Further provision must be made for disposition of the down payment if the transaction is not closed. Typically, the down payment will be returned to the buyer if the seller wrongfully refuses to close or retained by the seller if the buyer wrongfully refuses to close. The retention of the down payment by the seller raises another difficult question, especially if it is a significant part of the purchase price. The retention may be viewed by a court as a

forfeiture or penalty, both of which are disfavored under the law. For this reason, you should not use the words forfeiture or penalty in the agreement. The best method is to characterize it as liquidated damages which are paid to compensate the seller for its efforts in selling the property and keeping it off the market during the transaction. The problem with this approach is that it is very difficult, if not impossible, to determine the actual amount of the seller's loss arising from the aborted sale. The safest approach may be to include a provision in which the parties agree it will be very difficult to determine the actual amount of the seller's loss if the buyer fails to close and they agree the amount of the down payment is a reasonable amount of liquidated damages that will compensate the seller for the loss of the sale. Then, cross your fingers.

An associated problem is the right of specific performance, that is, the right of one party to force a defaulting party to complete the sale. Traditionally, the law has allowed a buyer of real property to force a seller to complete the sale but has not granted the same relief to the seller. The seller has been limited to the recovery of money damages. This arises from the concept that every tract of land is unique and a buyer cannot be adequately compensated by money damages, whereas monetary damages will compensate a seller for the loss of the sale. Both buyers and sellers of personal property have usually been limited to the recovery of money damages. However, the typical oil and gas transaction involves both real property and personal property and the law is in constant flux. Additionally, oil and gas leases may be considered to be real property for some purposes and personal property for other purposes. All of the foregoing may vary under the laws of the states. Therefore, it is important to address the issue of specific performance in the contract and state whether the right of specific performance will be granted or denied to the respective parties.

Provisions should be made for various adjustments to the purchase price. Typical adjustments are for properties dropped from the transaction because of incurable title defects, or for properties purchased by third parties under preexisting preferential rights to purchase. Another matter that will require adjustment is if the quantum of interest of the seller in a property is larger or smaller than originally provided in the contract. It will also be necessary to make adjustments at closing for properties for which closing is delayed. The parties should agree upon a price allocation for each of the properties and include the allocation in the contract. This may be accomplished by a side agreement incorporated into the contract by reference. Not only will an agreed price allocation avoid later controversy but it is usually necessary to inform third parties of the offered purchase price under a preferential right of purchase.

Another matter for price adjustment at closing is property taxes. The typical arrangement is that they will be prorated with the seller being responsible for taxes to the date of closing (or to the effective date) and with the buyer being responsible for them after that date. If the current taxes cannot be ascertained by the time of closing, it is typical to provide that the proration will be based upon the prior year's taxes with later adjustment to be made if the actual taxes differ from the estimated taxes by a specified amount.

The parties will probably provide for delayed closings for properties such as those for which title curative work is not complete but for which it appears title can be successfully

cured, properties for which the environmental assessment is not complete or other situations the parties anticipate at the time the purchase and sale agreement is executed. Critical dates should be established for the delayed closings. Provisions for delayed closings should be drafted as specifically as possible so you will not wind up with half of the deal closed simply because one or both parties were dilatory in their pre-closing efforts.

It will usually be necessary to provide for a post-closing accounting to adjust financial matters arising since the effective date such as income received by one party that is to be credited to the other and expenditures made by one party which are to be charged to the other. A reasonable date should be fixed for the accounting. The parties may wish to escrow a portion of the purchase price to cover any anticipated significant differences between the income and expenditures to be disbursed after the accounting is completed and mutually agreed upon.

The parties must also agree upon the disposition of that portion of the purchase price attributable to properties for which closing is delayed. This is similar to the issue of the down payment prior to closing. It should be specified as to whether the money will be held by the buyer, seller or a third party under an escrow agreement to be disbursed at the delayed closing.

Exhibits should be attached to the purchase and sale agreement which describe the properties to be conveyed under the agreement. Separate exhibits may be used for fee simple property interests such as buildings or yards, easements and rights of way and oil and gas mineral and leasehold interests. There may also be exhibits listing personal property. The property should be described in a legally sufficient manner. For example, some state laws require a conveyance of real property to contain a specific legal description. An assignment of an oil and gas lease must show that it covers the "SW/4 NW/4 of Section 3-8N-7W," not just that it is a lease from Joe Blow to Sam Landman recorded in Book 123, Page 456. The exhibits are usually divided into geographical areas and the descriptions on each exhibit are usually further subdivided into interests in individual wells. Information such as the following is typically shown for oil and gas leasehold interests on a well-by-well basis:

1. The well name, legal location and any other identification.
2. The nature and quantum of the seller's interest in the well. The quantum of working interest and net revenue interest, both before and after payout, should be shown. These numbers are typically shown in seven or eight digit decimals just as they are shown in the division order title opinions. It should be specified if the interests are of a nature other than a working interest such as a mineral interest, an overriding royalty interest or a carried working interest. It is not uncommon for a seller to have more than one interest in the well such as both a working interest and an overriding royalty interest. In that event, the quanta of the seller's interests should be separately described.
3. A description of the oil and gas leases in which the seller owns an interest. The description will typically show the names of the lessor and the lessee, the date of the lease, the recording data and the legal description of the lands covered by the lease. It is possible the seller will list its quantum of ownership interest in each lease but this is rarely encountered.
4. A description of the fee simple mineral interests the seller owns in the well.
5. In a state such as Oklahoma which provides for the force pooling of mineral and

leasehold owners, the exhibit may make reference to the interests it acquired under a specific force pooling order of the Oklahoma Corporation Commission.

6. A description of the encumbrances affecting the seller's interests. These are matters such as operating agreements, participation agreements, farmout agreements or orders of regulatory agencies.

Forms of the conveyances to be used in the transaction should be attached to the agreement. If this is done, there should be no controversy as to the language in the documents to be delivered at closing. Several types of conveyances may be needed. Deeds will be necessary for the conveyance of fee simple properties such as buildings or yards and mineral interests. Assignments will be necessary for the conveyance of easements, rights-of-way and oil and gas leasehold or contractual interests. Bills of sale will be needed for personal property.

The various conveyances are often combined into one form which contains the necessary language for all necessary matters such as the conveyance of fee simple surface and mineral interests, the assignment of easements and rights of way, the assignment of oil and gas leasehold interests, the assignment of contractual rights and a bill of sale for personal property. The agreement will provide that the exhibits describing the properties will be attached to the conveyances. There should also be a clause which provides that multiple conveyances will be executed, one for each recording office such as one for each county in a state and the appropriate exhibits will be attached. To reiterate one of the title attorneys' favorite complaints: if all of the interest of the seller is to be conveyed, do not limit the conveyance to the interests described in the exhibits. Please state that all of the interest of the seller is to be conveyed. In fact, many such conveyances state it is the intent of the parties that all interests of the seller in the described lands, even if misdescribed or omitted, is to be conveyed.

A time problem exists for interests such as federal, state or Indian leases which require an assignment to be made on the appropriate agency form and submitted for approval. The approved assignment will not be returned and available for recording in the county records until after it has gone through the bureaucratic process. Therefore, you may wish to include these leases in the general assignment together with a statement that the approved assignment will be recorded when it is received and that a double assignment is not intended.

You may wish to include provisions for cooperation by the parties in general and in specific instances because many joint efforts will be required to close the transaction. The seller should make a commitment to make a good faith effort to identify properties in which third parties hold preferential rights to purchase and send appropriate notices and requests for waivers to the third parties. It may be necessary for the seller to request approvals of transfer of operatorship under operating agreements. It may be necessary for both parties to jointly apply for transfers of governmental leases, assignments of operatorship from governmental authorities, etc. There will also be ongoing operations such as wells for which drilling elections must be made, wells which must be commenced to earn rights under third party agreements or wells which must be commenced to perpetuate oil and gas leases which are close to the ends of their primary terms. It will be necessary for both parties to execute transfer orders or letters in lieu of transfer orders and submit them to oil and gas purchasers.

Another important provision is known as the future assurances clause in which both parties agree to execute such further documents as may be necessary to complete the transaction and enable the buyer to enjoy the rights in the property as contemplated in the contract. This will ensure the execution of matters such as assignments of oil and gas leases that were inadvertently omitted from the closing documents.

The foregoing discussion has just hit the highlights of some of the matters that should be covered in a letter of intent and a purchase and sale agreement. Every situation is different, so be sure your intended contract provides for all of the matters that will arise in your transaction. Do not hesitate to seek advice from experienced persons who have been down the road before.

CHAPTER SIX

INTRODUCTION TO THE DUE DILIGENCE EXAMINATION

The name of the due diligence examination comes from provisions in the typical purchase and sale agreement that deal with the buyer's examination of the property and the seller's records. Such clauses typically provide that the buyer will have both the access and right to examine the property and pertinent files, books and records of the seller. The buyer is charged with knowledge of all defects or deficiencies he could have discovered through the exercise of due diligence in his examination of the property, the official title records and the files, books and records of the seller. Any objections to title or the physical condition of the properties not presented to the seller by a given date will be deemed to have been waived and the buyer will literally have to accept the property in an "as is, where is" condition.

"Due diligence" has come into common usage as a shorthand term for the buyer's examination of these records. You will see the buyer's examination referred to by terms such as "due diligence examination", "due diligence search" or just "due diligence." In fact, the term has come into such common usage that in some purchase and sale agreements the examination is merely referred to as the buyer's due diligence search without further definition except as to the records the seller will make available for examination and the standards of title.

The due diligence search will be discussed in the following three chapters which cover the inside examination, the outside examination and coordination of the entire due diligence search. The chapter on inside examination will cover examination of the seller's files, books and records. The chapter on outside examination will cover the physical examination of the property, the environmental examination and the examination of official title records. The chapter on coordination will cover matters such as chains of command, personnel and how to accomplish everything in an orderly manner.

It is very difficult to present a step by step written description of the procedures involved in planning and conducting a due diligence examination because all of the procedures are interrelated. In an actual examination, you will be doing everything at once in order to meet your critical dates. You will have to examine and consider many matters at the same time in order to evaluate them and put the information in perspective. You will be constantly modifying your plans and procedures to meet situations as they arise.

This presentation may appear to be out of order to you because only one thing at a time can be described on paper. Some parts may seem to be incomplete or to not make a lot of sense until you have read the following parts or perhaps the entire section. For example, you would logically expect coordination and chains of command to be discussed at the beginning of the section. However, it would be of little use to discuss these matters until the tasks and personnel needed to perform them had been explained. Therefore, the chapter on coordination falls at the very end of the section. One thing will be described at a time and it is hoped at the end they

will all fall in place in the reader's mind.

As you proceed, you should bear in mind that the primary goal of the due diligence search is to confirm that the seller has the ownership and standing to convey the interests described in the purchase and sale agreement to the buyer.

CHAPTER SEVEN

INSIDE EXAMINATIONS

Numerous types of seller's inside records should be examined in the due diligence search. The first part of this chapter will briefly cover some of them. Although they are matters that should be examined, they probably will not be examined by landmen because they require the attention of specialists such as oil and gas accountants or geologists. The job of the landman in charge of the due diligence examination will be to see that these examinations are performed and properly reported. Our main thrust will be the examination of the seller's title records.

Many modern records are stored in computers instead of in the form of hard copies on paper. Therefore, you should be aware the parties conducting the due diligence examination may have to review records as they exist in the seller's computers instead of reading them on paper. Your examination team should be prepared to investigate the seller's computer records and always remember to inquire as to the availability of such records in addition to hard files.

The results of each examination must be reported to the person in charge of the due diligence search so everything can be cross referenced, evaluated and presented to your client in an orderly manner. Therefore, before the examinations are commenced, it is recommended standardized forms be devised which will present all the information of interest. The report forms should be designed with two goals in mind. The first goal is to prepare reports that can be meaningfully used in evaluating the properties. The second goal is to present data that can be used in incorporating the seller's records into the buyer's system after the sale is closed.

Financial Records

Your accountants should examine the seller's financial records for the properties with respect to matters such as those listed below. You should consult with them as to additional matters that should be reviewed. Their findings should be cross checked to confirm that they agree with existing division orders, operating agreements, the ownership of the seller, etc.

1. Timely billing and receipt of operating costs from third parties.
2. Timely receipt of bills and payment of operating costs to third parties.
3. Timely receipt of proceeds from production from others.
4. Timely distribution of proceeds from production to others.
5. Proceeds in suspense, whether held by others for benefit of the seller or held by the seller or benefit of others.
6. Tax matters covering many topics such as confirming the seller has paid income, ad valorem or production taxes or ensuring that if the seller is a member of a tax partnership with respect to a property that the other partners have been identified and partnership tax returns have been prepared and submitted.
7. Overproduction or underproduction under gas balancing agreements.
8. Well payout status for units involving matters such as production payments, carried

working interests, back-ins or non-consent elections under operating agreements.

9. Status of gas sales contracts, examined with respect to their provisions by your gas contract specialists and with respect to takes and financial effects by your accountants.

Well Records

Geological, operational and production records should be reviewed by the appropriate technical personnel. Equipment listings should be cross-checked with the reports of the physical examination of the properties to confirm that the equipment shown in the well records is actually in place. Production records should be cross checked with the reports of the financial examination. If you are acquiring seismic data as part of the transaction you may wish to have your geophysicists evaluate it.

Computer Records

If you have to examine records that are in the seller's computer, you may need the advice of your computer expert to determine the best method of examining them. If you complete the purchase, you will have to incorporate the seller's records into your own records which will invariably involve transferring data from his computer system to yours. Therefore, at the earliest possible time your computer expert should confer with the seller's computer expert with regard to their computer system. He should study the seller's system and advise you on matters such as programs the seller uses to keep his records, methods of accessing them, types of computers he uses and the best method of transferring the records to your own record keeping system. You must evaluate and act on these recommendations as soon as possible, for at or within a specified time after closing you will be responsible for matters such as billing and paying operating expenses and royalties.

Your computer expert will probably present you with alternatives such as the following for transferring the data into your system. As used herein, the term system means both the computer program that is handling the data and the computer itself.

1. You are in luck. You and the seller use compatible systems, so data can be transferred directly from his system to yours.
2. You are somewhat lucky. The systems are different but he believes a program can be written that will transfer the data to your system with minimal data loss.
3. You are out of luck. The systems are incompatible, so you will have to print out the data from the seller's system and enter it into your system by hand.
4. You are really out of luck. Your existing system is too small to accommodate the additional information on the properties you are acquiring from the seller, so it will be necessary for you to acquire a new system. If the seller's system is large enough and is otherwise satisfactory you may wish to acquire a system such as the seller's (or acquire his system) and combine both sets of data into it.
5. In any event you may have to operate your system and the seller's system side by side until you have made arrangements to transfer data or to set up a new system.

The Inside Title Examination

The primary task of the land professional in the inside due diligence search is the examination of the seller's land title records. You will arrange for other specialists to cover the

matters discussed above but this is your specialty. You will utilize your knowledge of land matters to determine the quality of the seller's title. In essence, you will be determining whether the seller did his landwork properly when he was acquiring and developing the properties so he can convey the interests to your client pursuant to the terms of the purchase and sale agreement.

Planning and Arranging for the Inside Title Examination

Each due diligence search is a creature unto itself and develops its own pattern as you conduct the examination. Sometimes, you have a great deal of background information provided to you by your client which enables you to create a plan of approach before you begin your examination. At other times, you may begin with nothing but a list of the properties showing the size of the interests to be conveyed. Even the size of the interests shown on the list may be based upon preliminary information and may not be correct. The parties may be still negotiating terms of the purchase and sale agreement as you begin your search. Under these circumstances, you will have to invent your plan of approach as you conduct your examination. However, experience is the best teacher. After you have participated in a few due diligence examinations, you will develop a general plan of action to get you started under any circumstances.

You should work closely with your client at all stages of the examination. You are engaged in a dynamic process and both of you need to know information that has been discovered by the other. Your client needs to be informed of the progress of your examination because it affects the timing of the entire transaction. He should be informed immediately of serious or unique problems so he can begin working them out with the seller.

The material in this course is based on the assumption that the buyer and seller are serious about consummating the sale and are proceeding toward closing in good faith. It is therefore your duty and the duty of the seller's representatives to do everything possible to facilitate the transaction. Your task is not to find a problem and proclaim "title failure, title failure!" Your task is to discover any defects in the seller's title in order to protect your client and then work with the seller's representatives to cure them prior to the closing date. To achieve this, you and your client should inform the seller of problems as they are discovered so both of you can work together to devise satisfactory manners of curing them. The terms of the purchase and sale agreement will require the buyer to present written objections to title on or before a certain date. However, as a practical matter, it is best for the parties to begin working on solutions before then. If you wait to present objections on that date you have lost valuable time that could have been spent in curing the problems.

For discussion purposes, assume you have a copy of the executed purchase and sale agreement. Before you leave your office, the first step is to review the agreement. You should examine the list of the properties to be conveyed (usually Exhibit A) which should give both the working interest and net revenue interest of the seller in each property. Before and after payout figures should appear if applicable. These interests will probably be shown on the basis of the seller's total interest in a unit and not on a tract or lease by lease basis. The list may or may not show the agreements (operating agreements, farmout agreements, area of mutual interest agreements, etc.) to which the interests are subject. The list often does not specifically list the

burdens on the interests (lessor's royalty interests, overriding royalty interests, net profits interests, etc.), although their effect should be reflected in the net revenue figure. Your ultimate goal will be to confirm that the seller can convey to your client the interests described on this list pursuant to the terms of the agreement.

You should then review the body of the agreement to determine the standards for your examination. It will usually provide for qualifications to title to the interests shown on the list of properties. They are usually defined as permitted encumbrances and will not constitute objections to title, although in your reports you should note their existence because your client should be aware of them. There may be matters such as operating agreements, farmout agreements, governmental regulations or any other number of matters that may affect or restrict the interest of the seller.

You should determine whether the seller is warranting title or merely representing he owns a specified quantum of interest. The seller will probably be giving what is termed a "special" warranty, i.e., warranting title against claims by parties claiming by, through and under him but not otherwise. The seller is probably not making any further warranties or representations except that before closing, he is warranting or representing he has the ability to convey the interests listed on the exhibit subject only to the permitted encumbrances. The agreement may provide a standard for title examination (such as the Oklahoma Bar Association Title Examination Standards) and provide that certain matters will or will not be the basis for an objection to title. The agreement may reflect that the seller is obligated to assign certain interests to third parties and the interests set forth on the exhibit reflect the deduction of these interests from the seller's present record interest. The agreement will fix the closing date and set a deadline for the purchaser to submit objections to title.

You are usually working under severe time constraints when performing a due diligence search. Not only do the seller and buyer wish to close the sale as soon as possible but you are often working out of town at considerable expense to your client. It is essential to plan the course of your examination as far in advance as possible and proceed with the utmost speed and efficiency.

The client should prepare a major value list of the properties which ranks them according to their relative importance to him. Ranking on this list usually depends on the monetary value he has assigned to each property. The client will often establish a cut-off value below which you will not conduct examinations. Depending on circumstances such as the time available and amount of money he wishes to expend, there may be different cut-off values for inside and outside examinations.

The ideal way to conduct your search would be to examine the properties in the order in which they appear on the major value list. That way, if you run out of time, only the least important properties will get little or no scrutiny. However, some interests of relatively small size may be of great importance to the client. For example, your client may have participated in a well and may desire to become the operator. Even though the seller's interest in the well may be small, when added to the existing interest of the client, it may be sufficient to give him the majority interest in the unit.

Another exception to this rule is when title to two or more properties of disparate value is somehow interconnected. It may be convenient or necessary to examine them together. In one such situation, it was necessary to examine title to the least valuable unit in a transaction before title to the most valuable unit was examined. In that instance, the least valuable well was the first well drilled under a very complicated area development agreement. It was necessary to determine the parties' actions in the first unit before their ownership and obligations in succeeding units could be determined.

You must be realistic when planning your examination of the properties in relation to their rank on the major value list. The seller's files will often be organized on an area basis and not on a well-by-well basis so if you are blindly following the major value list, you may wind up wasting time by jumping from one set of files to another.

As will be discussed in more detail below, it is most efficient to examine all interrelated files at the same time. Therefore, you may wish to further analyze the major value list and begin your inside examination with the files for fields that are of the greatest value or which contain the most valuable wells. Then, if possible, follow the value ranking for wells within the field.

Your client may provide you with advance information such as title opinions, ownership lists and maps that will be of use to you in familiarizing yourself with the properties and planning your course of action, especially if he already owns interests in the properties. Therefore, be sure to ask for this information. You may even be able to begin calculating interests and preparing title requirements from this material. A word of caution, however. Your report is to be based on information that you find in the seller's files, public records, etc. When you examine the seller's files you should be sure that they contain this same material and that they do not contain conflicting information.

You will find a sample inside examination title report form in the appendix. It is merely an illustration and is not a format that must be followed. You should tailor your format from project to project, depending upon the matters you expect to find. For example, a paragraph concerning communitization agreements will only be needed where you anticipate Federal or Indian lands (or state lands in some states.) The sample form has been condensed for convenience in reproduction. In real life you should leave plenty of room for written comments. No pre-printed form will exactly fit all the situations you will encounter in a due diligence search, so you may have to modify it as necessary while conducting the examination.

Be realistic and practical when designing your title report form. Its primary function is to provide your client with information necessary to evaluate the purchase. This basic information can be summarized as follows:

1. Is the seller's interest of the size and nature as represented?
2. Is the property subject to any title defects?
3. Is the property subject to agreements, regulatory orders or other such matters that affect, restrict or possibly diminish the represented interests? (This is essentially a subset of the

paragraph above.)

4. Any other matters of particular interest to your client.

You should always bear this primary function in mind when designing your report form. Do not forget your objective is to provide your client with a summary of information he can quickly and conveniently use in evaluating the properties. Do not get carried away when designing your title report form. Stick to the essentials. Do not overload the reviewers with extraneous information that may be interesting but does not contribute to their evaluation of the properties within the context of the sales transaction.

A standard title report form serves several purposes in addition to convenience. It serves as a checklist to watch for specific matters such as preferential rights to purchase and prompts you to secure necessary information before you return home. It is an absolute necessity when many people are involved in the examination because it ensures uniformity in reporting and ensures that each report will contain the necessary information. Someone will have to review the reports for purposes of presenting title objections to the seller and determining whether to close the sale. A standard form enables the reviewer to look in exactly the same place in each report for the same information. This is important because the reviewer is also operating under time constraints.

A secondary and very useful purpose of the form is to serve as a source of information that can be used in incorporating the properties into the buyer's records after the sale is closed. You should make sure that copies of the forms are furnished to the appropriate departments after closing.

In many cases, it is a good idea to attach copies of title opinions, farmout agreements, operating agreements and any other pertinent documents to the title report. It may be necessary for the client to review them in detail prior to closing and he may be located a thousand miles from the seller's office.

You should prepare one title report for each well even though there may be more than one well in each unit. The reason for this is that interests may vary from well to well as a result of elections under operating agreements, underlying farmout or participation agreements, etc. If there is more than one well in a unit, you may wish to prepare a complete title report for the first well and simply refer to that report for common information in reports for subsequent wells. Each title report should show the well name, legal description, field, buyer's inventory number and any other identifying data that will make it easy to cross reference with other information on the property.

After you have performed these preliminary steps, you must assemble your due diligence team to examine the seller's internal records. It is assumed you have arranged for specialists to cover the matters noted in the beginning of the chapter. The assembly of the inside due diligence title examination team is one of those things that is easier said than done. The type of personnel you will need is fairly easy to describe. You will need a team composed of personnel who are familiar with subjects such as title matters, general oil and gas land work, division orders and oil and gas contracts. Typically, such people will be landmen, title analysts, division order analysts, lawyers, paralegals or others who have similar experience in the oil and

gas business.

The next chapter describes the manner in which to assemble an outside examination team. The criteria for selecting and assembling an inside team are very similar. Among other things, you may wish to select examiners who are familiar with operations in the various areas where the properties are located. In other words, you may have examiners who are familiar with Texas operations examining Texas properties, examiners who are familiar with Oklahoma operations examining Oklahoma properties and examiners who are familiar with federal operations examining properties in the Rocky Mountain states.

It is difficult to determine how many people you will need on your inside examination team and the particular skills required until you have an idea of the magnitude of the project, how many files will have to be examined and the condition of the files. If you are dealing with a massive project, you should visit the seller's facilities to see first hand the extent and condition of the records to be examined. At this point, you will simply have to make an educated guess as to how many of the files an examiner can review in a given amount of time. One method of estimation is to look at the number and nature of files in each area and to roughly estimate the amount of time needed to examine those files. You must constantly review the progress of the examination to see if you need to increase or decrease the number of examiners.

Equipment and Logistics

Although the simplest projects may require only a pad of paper and pencil, you should plan to bring all the office supplies needed to conduct your examination. The seller probably will not mind loaning you a stapler or a legal pad but sometimes it takes valuable time to find one. You should also inquire about the availability of calculators or bring your own. The area in which you will be working is often the last stop for calculators which work only half the time but which no one has had the heart to discard.

You will need to make copies of various instruments found in the seller's files so ask about the availability of a copying machine. You may have access to a copying machine in the seller's office or his employees may make copies for you. If the seller's employees are going to make copies, you should be aware there may be a time delay because of normal office business. The most efficient method may be to make copies of short instruments yourself and ask the seller's employees to make copies of lengthy instruments. If you are engaged in a massive project, you may wish to bring your own copier and clerical personnel to handle copying, typing and other office tasks.

A fax machine is extremely useful for rapid transmission of documents and information between the home office and the field examiners. This can be especially important if you will be on site for an extended period of time. If one is not available at the location where you are examining the seller's files, there are public machines available in places such as hotels, copy shops and grocery stores. However, you should exercise care when using a public machine because of potential confidentiality problems. If the circumstances warrant it, you should consider bringing your own fax machine.

Another matter to consider is the way in which you will transport the information that

you have so painstakingly accumulated, particular if you are working away from home and are traveling by plane. This may entail carrying heavy loads of precious papers through airports. You should have enough bags, briefcases or boxes to transport the material. A nylon backpacker's travel pack is useful for this purpose. The shoulder straps make it relatively easy to carry heavy loads of papers through airline terminals. If you have very large amounts of material you may wish to consider shipping them by fast carrier such as UPS or Federal Express.

If possible, avoid carrying your title reports and any other vital documents you are bringing back to your office in checked airline luggage. If Murphy's law prevails, you may not see them for a few days, if ever. Try to keep them with you in your carry-on luggage.

The Information Management System and Computers

If you are engaged in anything other than a very small project, you will have to devise an information management system that will allow you to keep track of the properties and status of the examination. This is where the ability to use a personal computer can be very valuable. The creation of an information management system is described in the following chapter on outside examinations. The same general principles also apply to setting up an information management system for the inside examination. If you use a computer you will probably wish to use a portable model such as a laptop or notebook because of the difficulty in transporting a full size desktop model and limitations in the work space available to you.

In order to print hard copies, you must either bring your own printer or make arrangements for the use of one. The seller may have a printer you can use. Some hotels have printers available for use by guests and many copy shops provide this service. Of course, as with fax machines, the use of a public facility such as a hotel or copy shop printer may not be very convenient and may pose confidentiality problems. If you are going to bring your own printer, you may wish to consider acquiring one of the specialized portable models instead of carrying a standard office size machine with you.

If you are going to use a printer in the seller's office, hotel or copy shop, it will probably be necessary to install that printer model in your applications program. Some programs require you to use the program disks to install additional printers. For that reason, you may need to carry copies of your program disks with you so you can install the appropriate printer. It is also a good idea to carry a short printer cable because the seller's printer may be attached to a long cable that extends to another room. You may also be faced with the problem of whether the printer is set up for a serial or parallel cable.

There are other ways to utilize computers in the inside due diligence search in addition to the information management system. Instead of making handwritten notes of the contents of a file, you can use a program such as a database to keep track of them. Many databases are limited to the use of specified fields which can only contain so much information but there are database programs available that allow you to enter and search textual information.

Another way to utilize a computer is to have your title report forms set up in blank on a

word processor or database program. That way, you can directly enter the information and print it out when needed instead of writing the information by hand on a printed form.

The use of a computer can not only do away with the need to carry large amounts of paper, but as the information is in electronic form you will find that it can be more easily searched and sorted than information on paper.

The computer can also be used to communicate with the home office and field examiners. If your computer has a modem or a fax/modem card, you can simply plug it into a telephone outlet and use it to send or receive messages, computer files and faxes. There are many commercial services available that allow you to transfer files, send electronic messages (E-mail) or send faxes to a fax machine even if you don't have a fax card. The details of computer communication are beyond the scope of the course but it is neither very complicated nor difficult to learn. Many books on the subject are available in computer stores. The hardware and software for computer communication are relatively inexpensive.

A few words of caution with respect to the use of computers. Computer use can be addictive so if you are not careful you can spend a lot of time working with your computer on a matter that could be more efficiently handled with a pencil, a notepad and a pocket calculator. Analyze the task to see if the use of a computer is really efficient. Always remember the law of nature regarding the perversity of inanimate objects. That is, a mechanical device will always fail at the most critical moment. In view of this, you should regularly back up the data on your computer's hard disk. Remember to carry plenty of floppy disks.

Performing the Inside Title Examination

The next step is to conduct the examination of the seller's files and records. This is ordinarily done at the seller's place of business. In many cases, your client is buying only the seller's interest in specific properties and not all the assets of the seller. Therefore, the seller will probably provide you with a room in which to work and will bring the pertinent files to you for examination. This is to your benefit because you (and by implication, your client) are only charged with knowledge of the contents of the files and records which were provided by the seller for your examination. On the other hand, if your client is buying all of the assets of the seller, you will probably be given access to all or most of the seller's facilities.

You should be aware if you are given free run of the seller's entire file room, land department or all of his offices, you may be charged with knowledge of everything they contain. Even though a particular item of information might be in an obscure location you would not normally have searched, you may be charged with knowledge of it. Also, you could conceivably run into confidentiality problems with respect to properties not included in the sale. For these reasons, you may wish to ask the seller to provide you with an isolated area for your work.

You should always ask the seller whether he has checked the files he is giving to you to make sure they do not contain confidential or proprietary information that has nothing to do with the property in question. You should also always ask the seller to double check to make sure he has given you all of the files dealing with the property. It is not uncommon for one to be accidentally overlooked or forgotten.

You should make it a point to establish a good relationship with the seller's employees. They are the best (and possibly the only) source of information about matters that may not be clearly explained in the files. They can explain the filing system and find files and other material for you. If the seller has been in financial straits, his filing and record-keeping may have suffered. If other potential purchasers have examined his files they may have left them in disarray. The seller's employees are the ones who can cut through these Gordian knots.

The first step in the examination process is to discover what material is available for examination. Most items can be loosely categorized as lists (including spreadsheets), maps or files. For purposes of our discussion, we will use rough categories which we shall refer to as prospects, areas (or fields) and units. These terms are not of importance except in the sense that we need a geographic basis for our discussion of the seller's records.

We will use the term "unit" as a single, spaced, production unit such as a 640 acre gas unit. You should bear in mind that such a unit may contain more than one well and geographically contain wells producing from different formations with different spacing. We will use the term "area" to denote a field or a group of units producing from a more or less continuous formation. The term "prospect" simply refers to a geographic area established by the seller, usually containing what he believes (or once believed) to be the total potential limits of a field. As so defined, the prospect is usually larger than the area. The client may not be purchasing all of the seller's interests in the entire prospect but just the seller's interests in what the client believes to be the proven field or area.

You must familiarize yourself with the seller's filing system. This can be a challenge because filing systems vary from company to company. It is usually necessary to get the seller's employees to give you a short course in their record management system. At this point, it is also useful to go over any available maps of the properties with them. They may have maps that are keyed to their file system, so the maps can serve as one route to the files you need.

Digressing from files to maps for a moment, it is useful to study all the maps that you can get your hands on. It may be difficult to see how matters relate to each other from simply reading about them in instruments in the files. A visual representation helps to put them into perspective. When seen on a map, it is much easier to grasp concepts such as the relationships between ownership tracts in a unit, ownership tracts from unit to unit in an area, the patterns in which wells have been drilled with respect to matters such as spacing authorizations, agreements between interest owners, geological considerations and a myriad of other matters.

You will probably find maps covering large areas which show the outlines of the properties being sold. These maps may show a variety of information such as well locations, operator's names, well types, total depths, producing formation(s) and completion dates. They may show information for abandoned wells and limited ownership information. You will probably find maps of each unit which will show the ownership tracts within the unit. You should be very cautious about relying on maps where tracts

have riparian boundaries. Even if they are of recent vintage, they may be based on old surveys and may not reflect the current boundaries.

Returning to the subject of the seller's filing system, you will discover that although the manner in which files are physically organized may differ from company to company, almost everyone uses the same types of files. We have outlined some of the files you may find along with documents you may expect to find in them. They may vary in name and different companies may keep certain documents in different files.

Prospect or Area Files

These files contain general information on the seller's activities in the area such as:

1. Pattern of development.
2. Area agreements.
3. Information on area facilities owned with third parties such as gas processing plants, detailed information is probably located in separate files.
4. Problems and successes in the area.
5. How the seller has interacted with other working interest owners (cooperation, hostility, etc.).

Contract or Deal Files

You may find contract files on either an area or unit basis. They will probably contain:

1. Operating agreements.
2. Exploration agreements.
3. Area of mutual interest agreements.
4. Farmout agreements.
5. Miscellaneous letter agreements.
6. Correspondence.
7. If the seller has participants or investors, the agreements with them may be in the contract file or in a separate series of files.
8. Communitization agreements if the unit includes federal or indian land and may be applicable in some states to state lands.

Title Files

These files usually appear on a unit basis. They should contain the entire chain of title opinions and title curative material.

1. Lease purchase title opinions.
2. Drilling title opinions.
3. Opinions on special problems or circumstances.
4. Division order title opinions.
5. Supplemental opinions.
6. There may be mortgage title opinions prepared for the seller's lender.
7. Title files may also contain curative instruments.

Lease Files

Geographic coverage:

1. If a lease covers lands in more than one unit, the seller may have only one file for the lease or may have separate files for the same lease on a unit by unit basis.
2. If the leases only cover lands in one unit, the seller may have a separate file for each lease.
3. The seller may have only one lease file for all leases in a unit or only one lease file for all leases in each tract in a unit.

The lease file may contain:

1. The original or a copy of the lease.
2. Supplemental or curative instruments such as ratifications, probate decrees, stipulations of interest or mortgage subordination agreements.
3. Rental division orders.
4. Delay rental receipts.
5. Any side agreements with Lessor.
6. Correspondence with Lessor.
7. Internal notes regarding dealings or problems with Lessor.
8. Easements and surface damage agreements taken from the Lessor, although these may be in the well file.
9. Assignments of the lease.
10. Title opinions, if not contained in separate title files.

Well Files (or Operating Files)

These files usually contain both information dealing with the operation of the well and information applicable to the entire unit.

1. Completion reports.
2. Daily drilling reports.
3. AFEs (authorities for expenditures from other participants).
4. Regulatory authority orders, which may include:
    a. Spacing orders (usually show permitted well locations).
    b. Force pooling orders.
    c. Well location exception orders.
    d. Increased density orders.
    e. Orders creating, approving or otherwise affecting enhanced recovery units.
    f. All other orders which specifically affect the unit.
5. Elections of parties.
6. Surveys of well locations and roads.
7. Well location permits (state or federal, as applicable).
8. Production reports.
9. Joint billing and working interest ownership information. (This may show the identity of parties who do not own interests of record, such as parties who invested in the well but whose interests are still held of record by the seller.)
10. Easements and surface damage releases.

Division Order Files

1. These files are often located in the seller's division order department, so you may not

see them unless you ask for them.

2. Look for division orders signed by the seller.
3. There may be separate division orders for oil and gas.
4. Gas division orders will usually identify the gas purchase contract.
5. Division orders should reflect before and after payout interests if applicable.
6. There may be several different levels of division orders:
    a. From your seller to the purchaser of production.
    b. From your seller to the unit operator or another working interest owner where they are collecting the proceeds and distributing them to your seller.
    c. From all parties where your seller is the unit operator, collects all or part of the proceeds, and distributes them to others.
    d. From your seller's lessors and overriding royalty interest owners where the seller collects the gross interest and distributes proceeds to them.
    e. Various combinations of the above.

The preceding list is in no manner a comprehensive list. There is no way to predict the types of files a company may keep, the names it may give them or to list their contents. The purpose of the list is simply to provide you with some hints as to where various types of documents may be found. Various circumstances may require the creation of a particular type of file, such as a lawsuit, limited partnership agreement or an extensive area of mutual interest agreement. Sometimes a file will be created just to contain documents associated with one difficult title problem. You should be aware that unit files will be far more extensive if the seller is the operator of the unit in question. Non-operators' unit files usually do not contain much more than what the operator has sent to the non-operators.

You may find you are up to your eyeballs in lists, spreadsheets and database printouts. You will find them in the files, bound into volumes and lying around on tables. Everyone likes to make lists and the ready accessibility of computers has multiplied man's ability to create them. You will find lists of interests, lists of leases, lists of production, pay lists (revenue decks), lists of wells and lists of everything imaginable, even lists of lists. When you think of lists you should include the information that may be in the seller's computer. There may be important information in the computer that has not been printed out. The problem is not just to find lists but to sort out the ones that are of use to you and evaluate their reliability.

You began your examination with the list of properties attached to the purchase and sale agreement. This is the most important list you have. However, it probably only shows the net working and revenue interests of the seller. It will not show the amounts and ownership of burdens such as Lessor's royalties or overriding royalty interests nor will it identify parties entitled to back-ins after payout or parties from whom the seller is entitled to back-ins. You will eventually determine these matters from the title opinions but you may find a list that neatly lays them out in one place. It is a great help in grasping the entire picture if you can see all of this information presented together. Comparing various lists of the interests with the list from the agreement is another way of confirming the seller and other parties have treated interests in the same manner as they are listed in the agreement.

Although the lists you find may be of great use to you in your search, you should

remember they are all suspect in the sense they are hearsay evidence. You probably will not know the identities of the persons who prepared them, the information on which they were based or the care with which the persons creating them entered the data. You should use them with appropriate caution because you have no independent proof of their accuracy.

You have now completed a quick inventory of the available material and determined where it is located in the seller's records. You look at what is probably a mountain of information, feel overwhelmed and ask yourself "what on earth do I do now?" The answer is you simply have to start somewhere. Look at the major value list. It will show properties that should receive your earliest attention. Your maps and other lists will give some insight as to how the properties are grouped and how some properties may be related to others.

One of the simplest ways to organize the examination is on an area-by-area basis. Assign the necessary number of people to each area. They should first examine the area (or prospect) files. These files should give you an indication as to how the area was developed and the existence of agreements affecting the entire area. Next, examine the files for the area on a unit-by-unit basis.

It is probable that many properties in an area are subject to the same agreements so when you have examined the controlling agreements for one property, you have in effect examined them for all other similarly affected properties. Many title questions may also be common to more than one property in an area. Therefore, it is most efficient to assign one examiner to all of the properties that may be subject to the same matters.

Although it is time consuming, you should review every instrument in each file. The only reference to an important matter may be on a telephone message slip randomly stuck in a file. The seller and a third party may have entered into a verbal agreement and acted upon it without properly memorializing it in a written agreement. Conducting a due diligence title search is like going through grandma's attic. You have to wade through a lot of junk to find the good stuff.

You should carefully note the contents of each file as you examine it and mark each document you need to copy. (Take lots of yellow stickers with you.) There is nothing so frustrating as to see something three files later relating to an earlier document which you thought was unimportant and ignored at the time. This leaves you with nothing to do but madly flip through prior files in an attempt to locate the ignored document. You should also note the name or identity of each file you examine and show it on your title report. This lets the client know exactly what material was examined. Also, as the client will probably receive the seller's files when the transaction is closed, this will let him know whether he has received the correct files. Another item to note is the existence of any abstracts. The purchaser will usually be entitled to possession of them after closing.

The Smell Test

One of the most important criteria is the "smell test." As you examine the files for a property, you develop a feeling for what is going on. If everything makes sense, adds up

and there are no documented problems, you develop a good feeling toward the property. However, if something doesn't quite add up or just doesn't seem to make sense, you may develop an uneasy feeling even though no problems or unanticipated transactions are documented in the files. In other words, it just doesn't smell right. In that event, you should follow your instinct and investigate further. Look for more information and ask the seller's employees about the possible existence of undocumented matters. If you are not able to resolve the question, relate your apprehensions to the client in your title report. Many problems have been discovered and solved simply because things did not smell right even though outward appearances were more or less normal.

Providing Information to the Outside Examiners

You should make arrangements to commence the outside examination as soon as possible so all information will be available before the deadline for submission of title requirements to the seller. Material to be provided to the outside examiners is covered below in the chapter on outside examinations.

Various Instruments of Note

Discussed below are some of the instruments you may find in the seller's files and matters of interest that may be contained in them. Again, you should remember it is impossible to create a comprehensive list and there is no way of predicting what instruments you may encounter. Two of your best tools are your imagination and your instinct.

Title Opinions

Attorney's title opinions are ordinarily the best evidence of the seller's record title as of the dates of coverage of the opinions. You should review them carefully to see that they confirm the seller's interest and note any unsatisfied comments or requirements that affect his interest. You should be sure they are based upon continuous title searches.

It may be necessary to review the entire chain of title opinions because division order title opinions often do not contain all the information you need. For example, the division order title opinion may show only the seller's decimal net revenue interest in the entire unit, may not show working interest decimals, may not show the equations by which the examiner calculated the interest or may be limited in scope to a certain well borehole, depth or formation. The division order attorney may have combined the seller's interest into one all inclusive but undecipherable fraction that does not separate matters of interest such as the leases under which he holds his interest and the burdens such as overriding royalty interests to which his interest is subject.

If the division order title opinion does not present the necessary information, you will need the information in the prior opinions to work backward in order to calculate the seller's net revenue interest and working interest in the unit and to determine his interest on a lease by lease or tract basis. If the opinion is depth- or formation-limited and you are buying the interest of the seller at all depths, it will be necessary to conduct a further examination from the date of the last opinion that covered all depths. In any event, it is prudent to review all title opinions covering your property. Some matters or title requirements may not have been reiterated in the division order title opinion.

You should apply the smell test to all title opinions. It is possible one may be based in part on incomplete or incorrect information provided to the examiner concerning agreements or intentions of the parties. For example, the examiner may not have been provided with or made aware of the existence of farmout agreements, operating agreements, area of mutual interest agreements or participation agreements. The title opinion is only one of the sources of information in the seller's files so you should always be sure to compare the information in the title opinions with the other information available to you.

Division Orders

You should examine all division orders contained in the seller's files as evidence that he is receiving proceeds from the specified interests. As noted in the file contents outline, some of the interests may be shown as gross interests. It will be necessary for you to calculate and deduct the amounts the seller is distributing to others in order to confirm his net interest. The interests shown in the division orders should agree with your list and with the interests as shown in the division order title opinion.

Operating Agreements

Operating agreements should be carefully examined because they contain a wide variety of provisions affecting the interests and relationships of the signatory parties. Some agreements may not be signed by all the working interest owners in a unit and there may be multiple agreements between various owners. You should watch for any amendments to the agreements.

If you are positive the operating agreement is on a standard printed form such as one of the American Association of Professional Landmen or Rocky Mountain Mineral Law Foundation forms, you can limit your examination to changes or additions to the printed matter and rely upon your knowledge of the contents of the standard form to comment on its provisions. Among other things, pay particular attention to the "Other Provisions" section of the form where the parties typically add additional provisions that are peculiar to the unit in question and may add to or radically change the effects of the printed provisions.

You should confirm that the interest of the seller as shown on Exhibit A to the operating agreement agrees with the interest on your list. You should note the area and depths it covers. It may extend to more than one unit, be limited to a specific formation or depth or be limited to the borehole of one well. In some instances, the parties may have agreed they will pay operating costs and receive proceeds from production as shown on the exhibit without regard to the actual record ownership of the parties. You should also note the existence of gas balancing agreements.

The operating agreement should be examined to determine whether it contains preferential right to purchase or maintenance of uniform interest provisions. If the agreement contains a preferential right to purchase in favor of the other parties, it will be necessary to contact them as soon as possible so they can elect whether or not to exercise their rights. If it contains a maintenance of uniform interest provision and you are only purchasing a portion of the interest of the seller, you may wish to secure waivers of this

provision from the other parties. There is some question as to whether this provision in the various A.A.P.L. 610 Model Form Operating Agreements is enforceable. Your client must make an informed business risk decision as to whether to secure such waivers.

The seller may have identified preferential rights to purchase as part of the information provided in its data room and may have identified them as one of its obligations under the purchase and sale agreement. Notwithstanding this, you may wish to assign someone to immediately examine all of the operating agreements (and possibly other agreements such as participation agreements or farmout agreements) in order to confirm the presence or absence of such preferential rights. It is not necessarily prudent to rely upon the representations of the seller because he may have missed some in his review of his properties. Again, your goal is not to get a "gotcha" on the seller, but to pave the way for the orderly acquisition of the properties.

You should examine and report the non-consent provisions of operating agreements which control future development of the unit (subsequent operations) and determine whether any non-consent events have occurred to date. The size of the seller's interest as shown on the Exhibit to the Purchase and Sale agreement may not reflect the before and after payout effects of non-consent elections by him or the other parties.

Instruments Affecting Federal, State and Indian Lands

A federal communitization agreement is necessary if the unit contains tracts covered by federal leases. It will list the interests of all parties in all leases in the unit on a tract by tract basis. This is one more way of confirming the interest of the seller. You should note the formation(s) covered by the agreement and its effective date. The date should be prior to the expiration dates of the leases in question. The agreement may contain various provisions of importance to you. The agreement must be signed by all owners of interests in the leases in the unit and by all lessors whose leases do not contain appropriate pooling clauses.

Similarly, a communitization agreement is necessary if the unit contains tracts of Indian land subject to the jurisdiction of the Bureau of Indian Affairs. Some states also require communitization agreements for the inclusion of state land into units.

If you are in an area where there are large blocks of federal land, the parties may have entered into a plan of unitization that provides for the exploration and development of multiple tracts of land and the perpetuation of non-producing leases during the time the unit is in effect. The parties will have also entered into a companion operating agreement. The plan will provide for the allocation of costs and proceeds among producing tracts. These instruments must be examined to determine their effect on the seller's interests.

Lease Provisions and Regulations

If time permits, you should examine every oil and gas lease that covers the properties. You should report all unique or unusual lease provisions and confirm that they have been complied with.

You should confirm that all assignments of leases requiring approval of the lessor or other parties such as federal, BIA or state leases have been properly approved, all delay rentals, shut-in royalties and minimum royalty payments have been timely paid and all governmental regulations have been complied with.

Agreements Between the Seller and Third Parties

Farmout agreements, area of mutual interest agreements, participation agreements, letter agreements and other such agreements should be examined in detail. These agreements will establish the rights and obligations of the parties and may be connected with other agreements such as operating agreements. It is impossible to describe all circumstances that may be covered by such agreements because they are contractual agreements that were created when the parties had specific situations in mind.

Circumstances and situations may have changed since the original agreement was entered into. The parties may have entered into supplemental agreements that modified it, covered ambiguities in the original agreement or further clarified it. Therefore, you should watch for any supplemental agreements.

The interests of the seller may be subject to being increased or decreased under such agreements. For example, a third party may have farmed out a lease to the seller and reserved an overriding royalty interest that is convertible to a working interest upon payout of the test well. Conversely, the seller may be the owner of a convertible override he reserved in a farmout to a third party. Each party to an area of mutual interest agreement is often obligated to offer a proportionate interest in any newly acquired leases to the other parties to the agreement. The assignability of rights under such agreements may be restricted. There may be provisions dealing with future operations such as the subsequent operations provisions we discussed in connection with operating agreements.

These agreements may contain time limitations such as a requirement to drill a well within a specified amount of time after the date of the agreement or a requirement for the drilling of subsequent wells at specified intervals of time.

As with operating agreements, you should determine and report the actions the parties have taken under the various third party agreements because they may not be reflected on the Exhibit to the Purchase and Sale agreement.

Enhanced Recovery Units

Enhanced recovery units are often large, older units with complex ownership. State law usually controls the manner in which such units are created but there are many units still in existence that were created before the enactment of state laws and regulations. The title work for many of these older units may not have been performed in accordance with the same standards that you would apply today. The parties creating the unit may have based ownership and participation on the claims of each individual owner instead of performing supplemental title examinations at the time of formation of the unit.

You must examine the plan of unitization creating the unit and any ancillary

operating agreements. The plan will show the participation of each tract which determines its allocation of costs and proceeds.

When planning the examination, you should be aware that it may take an examiner a great amount of time to examine the files for an enhanced recovery unit. You should also consider whether you will secure outside title reports for the seller's properties in the unit. This decision will be based upon factors you discover in your inside examination such as the complexity of title, your level of comfort based upon information in the seller's files and the cost of performing an outside examination.

Joint Venture, Partnership or Limited Partnership Agreements

If the interest of the seller is subject to an agreement such as a joint venture agreement, partnership agreement or limited partnership agreement, you should examine the instruments creating (and modifying) the relationship. These instruments may specify or limit the terms under which a party may convey its interest. Also, there may be statutory or common law restrictions from state to state such as the potential homestead or community property rights of the spouse of a joint venturer.

Consistency

In the examination, you should always note whether the seller's interests are consistently shown in all of the documents you examine, regardless of whether they are instruments generated internally by the seller or whether they are documents involving third parties such as division orders, operating agreements, communitization agreements, etc. Consistency is not proof of title but it is an important part of the smell test. It reassures you that the seller and all parties dealing with him have treated him as owning the interests that he has represented to your client.

Current Obligations and Necessary Actions

You and your team should watch for current obligations and necessary actions. An agreement may call for the seller to commence or participate in the drilling of a well prior to the closing date of the sale. You must communicate this to your client immediately because if the seller and buyer do not make arrangements to commence or participate, valuable property rights may be lost. You should attempt to discern the status of all wells on the properties. Wells may be drilling for which important decisions such as to complete or not to complete must be made. There may be wells which have been completed as dry holes but have not been plugged. In that case, your client will be buying the privilege of plugging the well.

Summary

When you perform a due diligence search, you have stepped outside the traditional landman's function as an examiner of official title records. You have become a detective with the obligation to look into every nook and cranny of the seller's records and go out of your way to ask pointed questions about everything that piques your interest and may affect the interests of your client. You have entered the seller's premises with the duty to find and evaluate in a limited amount of time every scrap of pertinent information in his records and report your findings to your client in a usable format. You must be very

thorough, consistent and steadfast in your investigation. However, you should always conduct yourself in a reasonable, polite and diplomatic manner.

CHAPTER EIGHT

OUTSIDE EXAMINATIONS

Three types of outside examinations are necessary for a complete due diligence search. They are the physical examination of the premises, the environmental examination and the examination of official title records. The discussion of the first two topics will be limited because they are not usually performed by landmen unless they are specialists in these areas. The job of the landman in charge will be to see that they are performed and properly reported.

Physical Inspection of the Premises

Someone must physically inspect the premises to determine the identity and condition of the equipment, as well as the general condition of the site. The term "premises" includes everything you are buying, from well sites to gas processing plants to pipeline facilities. The buyer may also wish to conduct tests on each well in order to confirm productivity and physical integrity. These tasks are usually performed or directed by someone from the buyer's operations or production department because they are familiar with such matters and will be responsible for operation of the premises after the purchase; however, the "surface inspection" and/or phase I environmental site assessment may be performed by a specialized land professional.

The person examining the premises should submit a written report on a standard form that includes all the information of interest to the buyer. The form should be designed by the department that is responsible for the examination because they are the most familiar with such technical details. However, someone who is familiar with the terms of the transaction should review the proposed form to make sure it contains all the information needed for the overall sales transaction. The information on the form will also be of use in preparing the bill of sale and in merging the property into the buyer's operations after the sale is closed.

The examiner should report on each major piece of equipment by describing identifying features such as make, model, serial number and condition. He should also report on the general condition of the premises, including any safety hazards or environmental problems he notices. If the seller is not the operator, you may wish to have the examiner contact the operator and discuss the operation with him. Also, if the examiner has a chance to visit with landowners or tenants, he should tactfully question them about their views on the way the property has been operated. It is useful to know the landowner's attitude in order to confirm that you are not inheriting an ongoing surface dispute.

If there is to be an extended period of time between the inspection and closing, you may wish to schedule a last minute inspection to confirm the that original equipment is still in place and the condition of the premises has not changed.

The Environmental Site Assessment

The performance of an environmental site assessment has become an essential part of a sales transaction in today's world. In addition to liability for compliance with governmental laws, rules and regulations, one is liable to the landowner for damage to the land. The costs and penalties for violations may be severe. Even though one is a purchaser who did not cause the damage, he or she may be held liable for the sins of their predecessors if they cannot prove that the predecessors caused the damage or if the predecessors are not able to respond financially. The best way the buyer can protect himself is to secure an environmental site examination and take appropriate steps prior to closing.

The environmental site assessment should be performed by a qualified independent third party. The ultimate reason for the environmental site assessment is to protect the buyer against future claims. If the assessment is performed by an employee of the buyer, it can later be argued, fairly or not, that the report of the employee was subject to internal influence, pressure or bias. When the client is deciding whether to use an inside or outside environmental site assessor, he should consider the factor that a report by a competent third party may be far less vulnerable to such allegations.

The environmental site assessment consists of two major parts, one of which is actually an inside examination. The inside part is the environmental audit, an examination of the seller's internal records to make sure they show that he has timely filed appropriate environmental reports with the proper governmental agencies and maintained appropriate files on environmental matters. This search can be performed by the buyer's personnel because it is essentially a due diligence search of the seller's files. All the environmental site assessor is reporting is what he did and did not find in the files and whether it appears to have been done properly. Of course, the person performing the search must be familiar with environmental reporting so he will know what to look for and how to analyze what he finds.

The other part of the environmental site assessment is the site examination. It consists of physical examination of the premises and inquiry to the state and federal agencies that would have files or records regarding the site which will be combined with the historical use and ownership information obtained through the title due diligence search. The stakes are high, so this is not a job for amateurs. Those performing these tasks should at least conform to the minimum standards of performance established by the AAPL in its protocol for the phase I environmental site assessment. Environmental professionals are available, individuals and companies who have training and expertise in these areas and who are listed in the registries of nationally known organizations of environmental professionals. Land professionals so qualified are Certified Professional Landmen/Environmental Site Assessors (CPL/ESAs).

As of the date this was written, to the author's knowledge there were no federal or state mandated or blessed certification procedures for environmental professionals. One of the few exceptions is that the National Registry of Environmental Professionals has been authorized to create and administer an examination for registration of Corrective Action Project Managers for the Texas Water Commission. More governmental approved certification procedures will undoubtedly be established in the future.

In general, to be listed in a registry of environmental professionals, the person must

have undergone formal education and specialized training that is acceptable to the registering organization. The training is often provided or supervised by the organization. One way to find qualified organizations and individuals is to ask friends and business acquaintances who have used such services in the past. Another way is to ask the staff of a recognized technical college or university for recommendations. Before you retain an environmental professional, you should establish a level of comfort by visiting with him about his training and experience in your area of concern.

The first step of the environmental site assessment is called "phase I." One part of this phase is a thorough physical examination of the property to identify existing and potential problems. If the examiner sees evidence of a problem such as an oil sheen on water or an area that is suspiciously bare of vegetation he will further investigate to determine the nature of the problem and its source. The examiner will also probably interview the landowner and the owners of the surrounding lands to see if they know of any environmental problems.

The examiner will check the records of local, state and federal agencies that have environmental jurisdiction over the property for any activity with respect to the site in question. He will also check to see that their records show that the seller has been in compliance with all environmental reporting procedures.

The examiner will check the property ownership records for at least the last fifty years to see if any record of ownership or use by an entity of the type could produce pollution or give rise to a violation. (A violation or a problem is called an "occurrence" in environmental parlance.) For example, if a gasoline station site was on the property, a solid waste landfill or ownership by a chemical or refining company, he will look for pollution that could have arisen from their use of the land.

The various steps of the environmental site assessment will also cover the surrounding lands if it seems appropriate. A polluter is liable for damage to all the lands he affects, so if you are going to buy the property, you need to know your liability for pollution of the surrounding lands. Conversely, pollution from surrounding lands may have migrated onto the land in question. This also needs to be identified so you can avoid liability for damage that you or your predecessors in title did not cause.

Prior to beginning the phase I environmental site assessment, you should confer with the environmental site assessor to decide what matters it will probably cover. He needs to know the purpose of the assessment and any information you may have on the use of the property and the types of pollution he may encounter. For example, if you inform him that he is examining an oil well site, he will know that he is primarily looking for oil field problems and not for the types of pollution attendant to chicken farms. He will not ignore other matters but he will have advance notice of some of the most likely sources of problems. The location of the site is also important, for some areas are known for certain types of pollution such as naturally occurring radioactive material (NORM). Radon gas, which may accumulate in pipes and casings, is one example of NORM. In essence, you and the assessor will be planning a limited phase I environmental site assessment that is appropriate for the circumstances and your needs.

When the assessor completes his phase I environmental site assessment, he will provide

you with a written report of the results. If he has detected the likely probability of an occurrence or a problem that must be addressed, he will recommend that a phase II environmental site assessment be conducted. The phase II assessment is a more intensive investigation to determine whether pollutants definitely exist and, if they do, their identity, quantity, specific location and source. This assessment may involve extensive sampling and testing, so it should be conducted by an organization with technical ability and expertise such as an environmental engineering company or by an experienced examiner using the resources of such an organization for technical services.

As with certification of environmental professionals, standards for environmental site assessments are still evolving. Numerous organizations, including the AAPL, have published standards for conducting environmental site assessments.

If the phase II environmental site assessment confirms the existence of a problem, the next step is the phase III environmental site assessment, a feasibility and remediation study. In this phase, the assessor will determine the ways in which the problem can be remediated and compare their relative physical and economic feasibilities. In simple English, this means to figure out ways to fix it, are they practical and how much will they cost.

You should work closely with the environmental site assessor and be sure he is aware of your critical dates. Everything in a sales transaction is on a tight time schedule so it is important to complete and review the phase I environmental site assessment report as quickly as possible. You should confer with the assessor regarding his findings if he has found any occurrences. If a phase II assessment is recommended, it will take time to schedule and conduct the assessment. There is a good chance that even if a phase II assessment can be completed before the critical date, a phase III assessment cannot.

Assuming that the purchase and sale agreement provides for a price adjustment for environmental remediation or the deletion of the property from the sale in the event of a significant environmental occurrence, it may be necessary to have the results of the phase III assessment in order to determine the amount of the adjustment or whether the problem is of sufficient magnitude to delete the property from the sale. If the phase III environmental site assessment is not available before the critical date, the buyer will be in a Catch-22 situation. The only way out of this quandary may be to provide in the agreement for a delayed closing with respect to such properties or for the deletion of properties that a phase II assessment shows as probably requiring significant remediation.

The buyer and seller should work together on environmental matters. The buyer should advise the seller as soon as possible of a phase I environmental site assessment report that indicates further investigation or action is necessary. The assessment may reveal matters of which the seller was not aware or have just occurred. Matters such as recently discovered leaks may require the seller's immediate attention. Potential problems may be quickly cured before actual damage occurs. Some matters such as the manner in which to halt an ongoing problem or the manner in which to cure a potential problem may call for the concurrence of both parties. Also, the seller may be required under law to report such matters within a given period of time after discovery. It is possible that knowledge of an occurrence by the buyer might be imputed

to the seller. This may sound far fetched but this is a developing area of law and what appears to be true today may be determined to be untrue tomorrow.

Examination of Official Title Records

In addition to your search of the seller's books and records, it will be necessary to conduct a search of the official records of each jurisdiction where a property is located or which has authority over the property. These records are usually county, state, federal or Indian records, although if a well is located in a municipality, it may be desirable to search the municipal records to confirm that a well has been drilled in accordance with the municipal ordinances. You are charged with constructive notice of the contents of many of these records. Essentially, constructive notice means the law states that a party has notice of the contents of a record, whether or not he actually sees it or even knows of its existence.

The outside examination is the classic title search with which the land professional is intimately familiar. The only difference is it will be limited to the seller's interest. Our discussion will cover the mechanics of conducting the search in the due diligence context.

You have several alternatives when determining the type of search to be conducted. Also, you can employ various combinations of types of searches for different properties in a single project. The decision as to which type to employ depends on factors such as the value of an individual property, the confidence you already have in the quality of the seller's title, the level of confidence you require and the amount of time and money you wish to expend on the examination.

The very simplest type of search is where you inform the outside examiner (usually a landman) of the description of the property, the name in which the seller holds record title and the date of certification of the last title opinion. Then, ask him to report whether there have been any conveyances of record by the seller subsequent to that date. For lack of a better name, we shall refer to this as a record check. This search is not very informative because it only tells you of the existence or absence of conveyances. It is also potentially inefficient because if the examiner does report something, further review may be necessary.

A landman's ownership report is far more informative and useful than a simple record check for the presence or absence of conveyances. This is the usual ownership report, simply limited to the seller's ownership. You should provide the landman with title opinions and other pertinent information. He will provide you with a report on the seller's current record ownership including lease information and title problems or discrepancies that appear of record.

The most comprehensive report is an attorney's acquisition title opinion based upon prior title opinions and a search of the official records. The title opinion will show objections to title in addition to a tabulation of ownership. This title search is often a "standup" examination of the records because of the time and expense involved in securing abstracts of title. Also, many abstracters are reluctant to prepare and certify an abstract covering the interest of only one party in a tract of land because of matters such as name changes not of record, instruments that cover the interests of more than one party and the difficulty of tracking instruments by

name instead of by legal description.

Another type of search combines the efforts of both a landman and an attorney. The landman views the records from the date of certification of the last title opinion and notes the recording data of all instruments affecting the seller's interest. He then submits this list, along with copies of the instruments, to the attorney for examination. This is literally the equivalent of having the landman prepare a supplemental abstract of title. The attorney then prepares an acquisition title opinion based upon the prior title opinions and the material submitted to him by the landman.

The preceding method can be very economical and efficient if title can be readily determined from the instruments submitted to the attorney. However, if title is obscure or complex and other instruments outside the chain searched by the landman must be searched for and examined, it will be necessary for the attorney to ask the landman to return to the records and find these instruments.

A number of problems can be encountered when using this method which will not be discovered until the attorney actually commences the examination. There may be assignments prior to the date of certification of the division order title opinion which the division order examiner briefed but which should be examined in detail to determine their effect on the total interest of the seller. One instrument in the chain of title may refer to another instrument not in the chain of title. This will not be discovered until the first instrument is actually examined. An instrument may be incorrectly indexed and thus not appear in the landman's abstract. The fact that it is missing will not be discovered until the instruments are actually examined and it is determined there is a gap in the chain of title.

It is the author's personal opinion that the most efficient method where title complexity is anticipated is for the attorney to search the records himself instead of having him work from material collected by another. This will enable him to identify problem areas and to look for other instruments while he is still in the records office. An alternative method is for the landman to prepare an ownership report in addition to accumulating the documents. This should reveal gaps in the chain of title so he can look for missing instruments before submitting the material to the attorney.

Planning and Arranging for the Outside Title Examination

If a property major value list has been prepared, the first step in planning and arranging for the outside title examination is to refer to it in order to determine which properties will be examined, the preferable order in which to examine them and the type of examination to employ for each property. You may wish to secure attorney's title opinions for the most valuable properties, landman's ownership reports for those of lesser value and record checks for those with the least value. If you are financing your acquisition, the lender may require title opinions for all properties on the major value list. If a major value list has not been prepared, you and your client must determine a logical and efficient sequence for the examination.

In the most perfect of all worlds, you would be able to complete your in-house due diligence examination before you commenced the outside title examinations. This would allow

you to assemble complete information on each property and have a very good idea of the status of title to each. However, this hardly ever happens in massive projects and seldom happens in small projects. It will probably be necessary for you to commence the outside examinations at the earliest possible time in order to have them completed before the date on which you are to present your objections to title to the seller.

If you have been able to schedule your in-house examination according to value rank on the major value list, the due diligence reports for the most valuable properties should be completed first and you should be able to start sending complete packets of information to the title examiners. However, this seldom occurs. The seller's files will be grouped by geographical areas such as fields and the in-house examination will essentially follow this grouping, taking the good with the bad.

One practical course of action is to have some of the inside examiners start looking for title opinions in the seller's files at the inception of the due diligence search and begin sending them to the outside examiners. Additional information such as copies of the due diligence reports can be sent to them as it becomes available.

The next step is to arrange for the services of outside examiners. If the properties are located in more than one state, you should consider having a team working in each state. If there is a very large number of properties in a state, you may even wish to consider dividing the state into areas and having a separate team for each area. The field team should consist of experienced examiners who are familiar with the oil and gas title law of the state and the manner in which official records are kept. This differs somewhat from the criteria for inside examiners who are examining the contents of the seller's files. The inside examiners are reviewing and reporting on the work of others. They are working with the results of title examinations rather than examining record title, so extensive knowledge of the law of a particular state is helpful, but not quite as critical. In the outside examination the examiners will be directly applying the law to determine the status of record title, so it is essential that they be knowledgeable in the law of the state.

The best source of competent examiners is people you have worked with in the past and in whom you have confidence. If you have not worked with anyone in the state where the properties are located, you can ask friends, business acquaintances and others in the industry to recommend people who have done satisfactory work for them. The team will often be working at a distance from you, so by default it will be operating largely on its own. Therefore, you should exercise great care in selecting competent and reliable personnel.

The easiest way to assemble a team is to select an individual or firm to be the field team leader in charge of the state examination and to charge them with responsibility for selecting such additional team members as may be necessary. The team leader will be in charge of the mechanics of the examination, making sure that the work is performed in a proper and timely fashion. The team members will report to him and he will report to you.

When you have selected a potential team leader, you should carefully review with them the scope of the project, their qualifications and your expectations with regard to his leadership

role. You should discuss the critical dates, determine the expected time commitment and make sure he can meet these deadlines and devote the appropriate amount of time to the project. You should assure yourself that the candidate is competent and able to effectively and efficiently handle the responsibility for the project. In addition to these factors, you should make sure that the candidate is a person with whom you can work comfortably. In essence, the team leader will be your deputy in the field. The ultimate success or failure of the project will depend upon their ability to responsibly manage and carry out their portion of the project.

It is very likely that your initial conference with the potential team leader will occur before the purchase and sale agreement has been signed by the parties, so it will be necessary to maintain confidentiality. At the very beginning of your conversation, you should inform him that the identities of the parties must be kept confidential and inquire as to whether he has any conflicts. It is always possible that he assisted the seller in preparing for the sale or that he represents a competing bidder. Along the same lines, if he has done work on the property for the seller in the past, it would be prudent for you to secure the permission of the seller for him to work on the project. The team leader will have to go through a similar process when he is contacting potential members for his team.

Establishing Ground Rules for the Outside Title Examination

You and the field team leader should discuss the type (or types) of examination to be conducted, what information you will provide to him and the records and documents he will be responsible for examining. You should establish a target date for the submission of title reports which is far enough in advance of the date for submission of title objections to the seller to allow you to review the title reports and prepare your deficiency letter. You should also reach an agreement regarding fees and reimbursable expenses. After your discussion you may wish to prepare and jointly execute a letter outlining these matters so there will be no misunderstandings.

The primary area of the buyer's concern will probably be oil and gas leasehold interests and fee mineral interests. However, the seller may also hold title to other interests such as easements. You must decide whether you want the examiner to include the other interests in his report and instruct him accordingly. Buyers often ask examiners to exclude matters such as easements because of the added cost.

You and the team leader should also establish ground rules with respect to unrecorded agreements such as farmout agreements, operating agreements, communitization agreements or plans of unitization. These instruments will probably be examined during the in-house search. It will constitute a double expenditure of time and money if the outside examiner also reviews them. Therefore, you may wish to agree that you will not furnish copies of them to him and he will not be responsible for examining and reporting on such agreements if they do not appear of record. The exception is where the agreement will affect the seller's interest and it will be necessary for the examiner to examine the agreement in order to determine ownership. Typical examples are where the parties to an operating agreement have agreed that ownership will be deemed to be as shown on Exhibit "A" to the agreement notwithstanding their record ownership, where it is necessary to examine a plan of unitization in order to determine tract participation or where an assignment is subject to the provisions of a farmout agreement.

Another matter to be discussed is the records the individual field examiner will examine if the leasehold is owned by or subject to regulation by state, federal or Indian agencies. Is he to examine the records of the appropriate agency or merely note that such records should be examined? Items you may wish to consider in making such a decision are the internal records you have seen in the seller's files, the length of time the property has been producing and the location of the record keeping office.

The following list represents typical records that should be examined. However, as records, their places of recording, and the need to examine a particular record vary from state to state, the list is presented as an example and not as an exhaustive reference.

1. County records, including:
    a. Deed records.
    b. Judgment dockets.
    c. Mechanic's and materialmen's lien dockets.
    d. Uniform Commercial Code records.
    e. Tax records.
2. Statewide central Uniform Commercial Code records.
3. Records of governmental agencies which own or have jurisdiction over the land in question such as state, federal and Indian land offices.
4. Federal court records. (The necessity to examine these may vary from state to state.)
5. State oil and gas regulatory agencies. (Not usually examined except to search or instruments such as pooling, spacing, location or production orders not found in the seller's files. However, you may wish to confirm that the seller is in good standing with the agency and has posted the appropriate bonds.)
6. Appropriate county or state records for partnerships, limited partnerships, corporations, etc. which show the seller has properly qualified to do business in the state. (These matters are usually covered in a comprehensive opinion by lead counsel and not in individual title opinions.)

Material to be Provided to the Title Examiner

For a complete and thorough examination of the seller's title to the properties, the outside examiner should be provided with the following items. In addition, you should provide him with any other material you think will be helpful or necessary to him in your particular situation. You may wish to omit some of the material if you are performing a less exhaustive examination.

1. The property major value list will show the examiner the properties to be examined and the order in which to examine them to ensure that the most valuable properties get top priority.

2. Copies of the exhibit pages or other lists which describe the properties, show the seller's working interest and net revenue interest in each property and the descriptions of the leases to be assigned. The title report will show that, based upon the information you provided to the examiner and upon her examination of the official records, the seller can

or cannot deliver these quanta of interest.

3. A list of the names in which the seller may hold title, including names under which the seller does business and the names of predecessor companies is helpful to compile a company history of the seller which shows the dates of name changes, mergers and acquisitions.

4. Copies of the division order title opinion (DOTO) and any supplemental division order title opinions for the property should show the examiner the starting date for the examination, the size of the seller's interests as of the date of certification of the opinion and any title problems that existed as of that date.

5. It is a good idea to provide the examiner with copies of all the base title opinions in addition to the DOTO. If the DOTO only shows the interests of the parties on a unit basis, the examiner may need the base opinions in order to determine the ownership of the seller in specific tracts and in the leases to be assigned. The DOTO may show only net revenue interests and not working interests. The title attorney rendering the DOTO may not have carried lease descriptions or title requirements forward from the base opinions or may have shown unsatisfied or waived requirements in such an abbreviated manner that you cannot determine their substance. Also, if the DOTO is limited to production from a specific formation or a specific well, it will be necessary to look to the base opinions to determine complete ownership.

6. Copies of your in-house due diligence reports will provide the examiner information on matters not of record that may affect her title report or explain apparent discrepancies in record ownership.

7. Copies of applicable agreements such as farmout, operating or communitization agreements or plans of unitization if the examiner is responsible for examining them or if it is necessary to examine them in order to determine ownership.

Title Report Formats

As in all other phases of the due diligence examination, the examiners' reports should be made on a standard form. Most landmen follow a similar format for an ownership report; however, you should make sure he understands that the report should show the beginning and ending dates of the examination, the decimal working interest and net revenue interest of the seller and contain the title information of interest to you. The report should be identified by the well name, legal description and any property number you have assigned to the property so you can easily cross reference it to other materials.

Title opinion formats often vary widely from attorney to attorney. Even though two attorneys' opinions may contain the same information, it may be presented in a different manner and appear in a different place. For purposes of the due diligence search you must be able to quickly look at each opinion to find the information of interest to you. Therefore, it is suggested that the landman, client and examining attorney agree upon a standard format so the information will appear in the same manner and in the same place in each opinion.

A sample acquisition title opinion form actually used in a massive project is shown in the appendix. Only the names and legal descriptions have been changed to protect the innocent. You will note this opinion form covers Oklahoma property and thus addresses matters of concern under Oklahoma law. Your form will vary as necessary for use from state to state. Just remember it is advisable to have every examining attorney in the same state use the same format.

Briefly look at the sample opinion for an illustration of some of the matters to consider when designing your standard format. The first matter of importance is the heading. It should contain the well name, legal description, field, buyer's inventory number and any other information that will make it easy to cross reference it with other information on the property. If there is more than one well on the tract, the names of all the wells should appear in the heading.

The introductory paragraph makes it clear the opinion is a limited opinion which only covers the seller's interest in the property. The ownership of the seller is then shown in a detailed manner. It is broken down into tracts, depths, nature of interest and before and after payout as appropriate. The fractional ownership is shown so you can see how the examiner made his calculations. You and the examiner may be a thousand miles apart when you read the opinion so you can't get together for lunch while he explains how he arrived at his net revenue interest decimal.

Mortgages, court actions and liens affecting the seller's interest are shown under encumbrances. The section entitled comments covers two types of matters. One is the examiner's caveats as to matters he did not cover, the title standard he used and matters beyond his control. The other is general information of which you should be aware such as the orders of regulatory agencies affecting the property.

Do not be surprised at the number of caveats in the acquisition title opinion. It is often prepared from a standup examination of the county records which may not be as complete or accurate as an abstract of title. The attorney wishes to clearly show the matters he did not examine and the standard he followed in preparing the opinion. He will also recite ground rules established with the client such as comment number seven regarding examination of unrecorded agreements.

Objections and requirements are broken into two classes: title requirements from prior opinions and new matters arising since the date of the last opinion. The examiner should only address prior requirements and new matters that affect the interest of the seller. The acquisition opinion is limited to the seller's title and is not a drilling or division order opinion, so matters affecting only the interests of other parties should be ignored.

Unsatisfied requirements from prior opinions should not be cryptically shown as "unsatisfied." They should be reiterated in a manner such as requirements one and six of the sample opinion so the buyer can quickly comprehend the problem and the required curative action without referring to the prior opinions. The buyer will be using them to prepare his

deficiency letter to the seller and will not have time to dig out the base opinion to prepare a requirement for the deficiency letter.

All acquisition title opinions should contain a flat statement such as objection number nine (new) of the sample opinion which says the examiner can or can not confirm the interest of the seller as shown in the purchase and sale agreement. If there is a difference, he should show the amount of the difference and explain it if possible.

Page nine of Exhibit "A" shows the material on which the opinion was based. If you need to secure a drilling opinion or a division order title opinion in the future, the exhibit will provide you with the latest list of available prior title opinions.

Mortgagee's Title Opinions

If the buyer is financing the acquisition, his lender may require mortgagee's title opinions instead of acquisition title opinions. They present the same information with respect to the seller's title, but may differ in format and content. The mortgagee's title opinion serves two purposes. It serves as the buyer's acquisition title opinion because it provides the information the buyer needs to evaluate the seller's title. It also provides the lender with information it requires to evaluate the advisability of funding the loan.

The examiner should be aware that the potential for a conflict of interest exists. The mortgagee's title opinion will be addressed to the lender and is technically prepared for its benefit but the buyer will be paying the examiner's fees. Also, the buyer's ability to purchase the property depends in part on the findings in the title opinion because the quality of the seller's title is one of the criteria the lender will consider when making its final decision as to whether or not to fund the loan. Therefore, the examiner must be above reproach and scrupulously neutral in his findings.

The lender will probably provide its own form for the mortgagee's title opinion. The examining attorney must carefully review the form to be sure he can certify to the matters requested by the lender. As an extreme example, some forms call for the attorney to certify to matters beyond his knowledge such as the authority of the seller to sell and the buyer to buy. This is not a matter to be addressed by the examiner who is reporting on title to a well in Alfalfa County, Oklahoma. To certify this, he would have to examine corporate records in both the seller's home office and in the buyer's home office. Matters such as the foregoing should be addressed in comprehensive opinion letters by lead counsel for the parties and not in title opinions for individual properties.

In either the mortgagee's title opinion or a supplemental opinion to be prepared after the transaction is closed, the lender may ask the examiner to comment on the provisions of the mortgage with respect to questions such as whether it covers future advances or the effectiveness of an assignment of production. Matters such as this affect all the properties within a given state, so arrangements should be made to cover this topic in one opinion for the entire state and not in individual title opinions. The lender should also be informed in advance if certain issues for which it has requested an opinion are undecided or unclear under state law.

The proposed form of the mortgagee's title opinion should be reviewed at the earliest possible time. If there are questions regarding the matters it will cover, it will be necessary to confer with the representatives of the lender to agree upon the manner in which they will be addressed.

Last Minute Title Checks

In some circumstances, especially if the seller is in dire financial straits or if a considerable amount of time has passed between the title examination and the closing, you may wish to perform a last minute record check before closing to confirm that no intervening instruments have been filed of record.

Post Closing Title Reports

It is prudent to check the deed records after closing to ensure that all conveyances have been properly recorded and indexed. The simplest way to accomplish this is to have the records checked and a report prepared which confirms that the instruments have been so indexed and recorded and no intervening instruments were filed of record since the date of the last examination. Another method is to have an attorney prepare a supplemental acquisition title opinion.

If a lender is involved, it will probably require a supplemental mortgagee's title opinion which confirms that the instruments have been properly indexed and recorded and that the lender's mortgage and security interest are first and prior liens on the properties.

Performing the Outside Examination

The land professional's responsibility as a field team leader is to see that title to all properties in each assigned area on the major value list is examined and title reports are submitted to the buyer prior to the critical date. You are both the straw boss for the examination effort in your area and liaison between the individual examiners and the buyer's representative in charge of the due diligence search. As noted above, in your initial conferences with the buyer's representative you will have agreed upon general matters such as the types of examination that will be conducted for various properties, the ground rules as to what matters will be covered by the examination, the target date for submission of title reports, charges for fees and expenses and the format for the title reports.

The field examination is a very important part of the acquisition process because the buyer will be basing his objections to the seller's title upon your reports. If a lender is involved, its decision as to whether to finance the acquisition will be based in part on your findings. It goes without saying that your reputation, as well as that of the buyer's representative who employed you, depends upon the performance of your team.

Your first task after establishing the ground rules will be to determine the number of landmen and attorneys needed to perform the title examinations in the time allotted. At this point in time, you may not have the major value list, so your first estimate may have to be based on your conversations with in-house personnel regarding the counties in which the properties are located and the approximate number of wells in each county. For our purposes, we will assume you have a copy of the major value list. We will also assume you are an experienced

landman or attorney familiar with the title peculiarities of the various areas in your state and the probable amount of time it will take to examine title to properties in each area.

The following discussion assumes you are involved in a massive project. The procedures for small and massive projects are essentially the same. The main difference is that as the massive project involves many properties, more time and effort must be spent in planning, organization, administration and execution. In a small project, you simply have fewer people and smaller quantities of paper to worry about.

One of your first concerns in determining the number of people you will need is the amount of time you will be able to personally devote to different aspects of the project. If the project is small, you may be able to examine title to all of the properties yourself or only need the assistance of one or two other examiners. However, if it is a massive project, a great deal of your time will be occupied with administrative duties. You will have to spend much of your time in your office so you will be available for consultation with in-house personnel and individual field examiners. You will also be concerned with the assembly and dissemination of information and the preparation of comprehensive opinions that affect all of the properties in your area.

When you are planning the examination effort for a massive project, you should take these things into consideration and recognize that you may have little time to personally conduct title searches. You should probably plan to only examine title to properties in areas close to your office so you will be available for the other administrative matters. In your capacity as field team leader, you may be less of an examiner and more of an administrator.

Among the things to consider when estimating the number of examiners you will need are the counties in which the properties are located, the distances of the county seats from your office, the number of properties in each county and the time you estimate it will take an examiner to prepare a title opinion for an average property in a given county. You should look at the properties an examiner can efficiently cover in a loop from his home base and divide the work into areas on this basis.

It is suggested you engage the minimum number of people needed to perform the work in the time available. It is easier to manage and communicate with a small group. The fewer the people, the more each one will know about the project and the less explaining you will have to do. You are dealing with human nature, so morale and attitude are important factors. Each examiner will be more enthusiastic about the project if it represents a sizable amount of work (and thus income) to him. He will also put more of himself into it if he feels his efforts are a significant part of the project.

You will probably assemble your team from fellow examiners located in your area. Not only are you familiar with them and the quality of their work, but the logistics will also be easier. You will have to transmit many documents to them over the course of the project and it will be necessary for you to confer with each other fairly often. However, in instances where there are only a few properties in a distant county and there are no other properties that can be examined when making a loop, it may be more efficient to engage an examiner who is

headquartered in or near the county where the property is located.

You will essentially use the same process to engage team members as described above for the selection of a team leader. One additional factor to consider is that various areas within a state are often known for having unique title characteristics. If possible, try to match examiners to areas by assigning them to areas in which they are knowledgeable and have past experience.

You should inform potential team members of the fee arrangements you have made with the buyer and make sure they are acceptable. If you are engaging a firm, you should make it clear they are to assign only experienced examiners to the project. The due diligence record title examination is usually a demanding rush project with no time for on the job training.

When interviewing potential team members, you should be sure to emphasize matters such as the critical dates and the fact that everyone will be expected to use a standard form for title reports. Everyone must be willing and able to commit the necessary time and effort even if the project consumes more time than originally estimated. Everyone must be aware of the target date for submission of title reports to the buyer. They must realize the buyer needs this time cushion in order to review the title reports and prepare his objections to the seller's title before the critical date for submission of objections to title fixed in the purchase and sale agreement.

You have now made arrangements with the buyer's representative and assembled a team of field examiners. You have established a tentative plan for the orderly examination of title to the properties in your area. The next thing is to brace yourself to receive a flood of documents. The inside examiners will begin sending you information as fast as they can pull it from the seller's files. The first things you will probably receive are copies of title opinions, to be followed by in-house due diligence reports and other documents the inside examiners believe will be of use to you.

You will have to devise an information management system that will allow you to keep track of the documents, segregate them as to the properties they cover, determine additional documents that are needed, forward copies of the documents to the responsible field examiners and keep track of the examiners' progress. You should keep copies of everything you provide to the examiners so you will have them to refer to if questions arise.

If you are old fashioned, you can keep track of all this information on index cards, note pads or hand written spread sheets; however, on larger jobs, it may be difficult to be competitively efficient without using a computer. The information will be coming to you and you will be forwarding it to the examiners at such a rate that it is advisable to consider using a computer to keep track of it.

Spreadsheet and word processing computer programs are useful in managing an outside examination project. The data on the properties can be divided into convenient areas such as county and field for manipulation and retrieval. The spreadsheet is useful for quick look information such as well name, client's identifying number, legal description, name of the

examiner, the date on which the title information was provided to the examiner and the date on which the title report was submitted to the client. Most spreadsheets have a limited database ability so that the data contained in them can be searched and sorted. The word processor is used to tabulate this data plus more detailed textual information on each property such as the title information available, the date it was received and additional information needed to examine title. You can quickly extract and print the tabulation for a property for which more title information is needed and send it to the inside examiner so he knows exactly what the problem is and what he needs to furnish to you.

The following is a typical word processor tabulation format which shows the initial information and updates. This format was used in a particular project. You should not follow it blindly, but devise one appropriate for your uses.

(1) Well Name: Smith #1
Description: All of Sec 13-11N-14W
Inventory No.:123456
Have Exhibit: Yes
Due Diligence: Yes (2/24/93)
Title Opinion: (2/11/93) No DOTO, but have copies of the following Drilling Opinions:
(1) NW/4 - 5/2/74, certified to 4/30/74 at 8:00 a.m.
(2) SW/4 - 7/2/74, certified to 5/6/74 at 8:00 a.m.
(3) SE/4 - 5/14/74, certified to 4/17/74 at 8:00 a.m.
(4) NE/4 - NO TITLE OPINION

NEW (2/17/93) Have DOTO dated 1/30/75, certified to 12/28/74 at 8:00 a.m., prepared by Sam Browne for Serendipity Oil Company, covers all of Sec 23, shows ownership on a unit basis, limited to Red Fork formation, no obvious reason for limitation except spacing.

The use of two computer programs is in itself somewhat inefficient, because unless you can link files together so a change in one is reflected in the other, you will have to separately enter some of the same data in each program. A good database program would perform the jobs of both the word processor and spreadsheet programs and give you more flexibility in sorting. However, many database programs are limited in the amount of textual data they can handle and are less flexible once a format has been defined, so you lose the freedom to insert unlimited amounts of information you have in a word processor. Many word processing programs have a limited database capability but they also have a limited ability to handle textual data when used in their database role. The type of computer program to use is a matter of personal taste and may largely depend on the programs with which you are familiar and which you have available.

As soon as you begin receiving title documents from the inside examiners, you should segregate them as to the properties they cover and enter them into your information management system. You should quickly review the documents for each property to determine whether there is sufficient information to perform a title examination for that property. If there is not, inform the inside examiners of additional information needed.

You should periodically send a copy of your property listing spreadsheet to the buyer's representative for review so he can confirm that your list contains all the properties to be examined and does not contain any properties that are not to be examined. If you started compiling your list when you first began receiving information and before you received the major value list, you may have included properties that were not to be examined. It is also possible properties have been added to the list without your knowledge. This review will provide both of you with a great deal of comfort.

The suggested procedure is to accumulate the documents and transmit them to the individual examiners when you have gathered sufficient information for them to begin their title examination. However, as they need time to examine the documents before they commence their examination of the records, you may wish to begin providing information to them before you have assembled all of the information for their area.

It is most efficient for an examiner to travel to a county and begin his record examination after he has received the information necessary to examine title to all properties in that county. However, it is vital to get the title reports to the buyer's representative in a timely manner, so if the examiner can commence examination of most of the properties, the cost of returning to the county to examine title to the remaining ones may be justified. You and the examiner must exercise your collective judgment as to the most reasonable manner in which to proceed.

As the team leader, you are responsible for seeing that all title reports are submitted in a timely manner and the buyer's representative will wish to be informed of your progress. Therefore, you should periodically check with the individual examiners to ascertain the status of their work.

Submission of Title Reports

As time is usually a critical factor, the individual examiners should be instructed to transmit their title reports directly to the buyer's representative and send copies of them to the team leader. Time will be wasted if the examiners submit the originals to the team leader to be forwarded to the buyer. If time permits, the examiners should submit the reports in logical groups such as all the reports for one county or one field. This makes it easier to keep track of the opinions and review them. The same requirements may appear in many of the title opinions in the same area so they can be considered at the same time.

The team leader should review the reports for completeness and the nature of the title requirements so he will be prepared to discuss them with the buyer's representative if necessary. He should enter the date they were submitted into his information management system so he will have a record of the status of the entire project.

The buyer's representative may wish to discuss title requirements and methods of curing them with the team leader but in the case of difficult or complex requirements, it may be necessary for the representative to confer with the individual who examined title. He is the person who knows the most about the context in which he wrote the requirement. Unless the buyer is going to internally review and pass on the sufficiency of curative material submitted by

the seller, it should be submitted to the individual examiners for review and preparation of supplemental opinion letters.

It is possible the buyer will forward additional title material to the team leader after the examiner has submitted his title report. In that event, the leader should forward the additional information to the examiner with instructions for him to submit a supplemental opinion letter if the information changes the matters shown in his original report.

Special Circumstances

There will be certain matters that will affect all or many titles in the entire state such as examination of the central Uniform Commercial Code records, examining state records to confirm the fact that the selling entity is qualified to do business in the state, securing copies of orders from state regulatory agencies or the preparation of opinions as to the effects of provisions in the mortgage to be used by the lender in the transaction. Either the buyer's representative or the team leader should arrange for specific personnel to perform these tasks so the efforts will not be duplicated by the individual title examiners.

You can expect to run into situations that will make you want to tear your hair out. You and the buyer's representative must often exercise a great deal of ingenuity. One example is where the seller's files on a property do not contain title opinions or ownership reports and copies cannot be secured from others. It may be because a well was drilled without title opinions, the opinions have been lost or the seller acquired the property in the past from another party and did not secure copies of the opinions. The object is to complete the sale so you must devise some manner in which to confirm the seller's title at a level of risk that is acceptable to the buyer.

The most obvious solution to the foregoing problem is to have the examiner prepare a complete report from the records. However, if title is complex it may be inordinately expensive or impossible to do this prior to the critical date. Solving problems such as this may be like stepping into the La Brea tar pits. Every potential solution may have some drawback. Every time you get one foot loose, you discover that your other foot has become stuck in the tar. If the well has been on line for a long time and the seller's internal records indicate that his title is reliable, the buyer may be satisfied with merely confirming the assignment of leasehold interests into the seller and confirming that no subsequent instruments appear of record. The other side of this coin is that if the seller does not own all leasehold interest in the unit, this will not allow you to independently calculate his working interest and net revenue interest.

No matter how carefully you, your team members and the buyer's representative plan the outside examination, unexpected circumstances are sure to arise. You must be constantly prepared to recognize and respond to unanticipated situations and to develop solutions for the problems they present.

CHAPTER NINE

COORDINATION OF THE DUE DILIGENCE SEARCH

The preceding chapters covered the selection and duties of the members of the due diligence team. You have seen that a due diligence search involves many separate tasks which must be completed in a short period of time. If the project is anything but a small project, it will require the efforts of a large number of people. The due diligence search must be carefully planned and organized in order to coordinate the efforts of many people. This chapter will discuss chains of command and the manner in which to coordinate the work of the individual examiners.

It is a basic management principle that every project should have only one person in charge. That person should have the power, authority and responsibility to make decisions and direct the efforts of others. Having more than one person with equal decision-making authority can lead to inordinate delays or to weak decision-making as a result of conflicting opinions. Accordingly, it is suggested that one of the first steps in the process should be to select one person to be the project manager in overall charge of the due diligence search.

In a small project, everyone knows what is going on and can freely ask questions of anyone else without interrupting or disturbing the progress of the project. However, communications and responsibility in a larger project must be organized into chains of command because of the sheer magnitude of the amount of information to be dealt with. The project manager is charged with overall organization and supervision of the project and will not have time to familiarize himself with every minute detail of the examination or discuss every question or issue with every examiner. If he tries to directly supervise every individual, he will not have time to perform his own duties.

A definite chain of command should extend from the project manager to each individual worker. Instructions and directions should pass from the higher levels down through the chain of command. Questions and results should pass upward from the lower levels through the chain of command to the person who is authorized to make a decision or is to receive the reports. If the chain of command is not followed in a massive project, confusion and inefficiency may result.

The project manager should divide the project into the appropriate number of areas (tasks), designate a leader to be in charge of each area and determine the number of workers needed in each area. If the project is large enough, these areas may be still further subdivided with leaders in charge of the smaller units.

The due diligence search is not a cut and dried project. It is difficult to anticipate the magnitude and complexity of the work to be done and your initial plans will probably be modified as the project progresses. Therefore, your best initial procedure as project manager is

to make your best guess as to the division of the project into areas, select area leaders and to consult with them as to the number of workers needed and what they will do.

Each leader, from the project manager down, should have primary responsibility for the task assigned to his unit. The authority and responsibility of each leader should be defined so he knows the task of his unit and what matters he can handle without asking for instructions or advice from a higher authority. At every level, each worker should know his individual task, to whom he reports and who he can ask for instructions and answers to his questions. That is not to say the project should be divided into individual fiefdoms with everyone operating on his own without consulting with anyone else, nor should the project manager or respective unit leaders operate as dictators. There should be a liberal exchange of information and everyone from the project manager down should freely and willingly confer and consult with each other. The seller's overall operations are intrinsically interrelated so information discovered in one area can provide an answer to a question in another area. The emphasis here is each leader should have his own area of responsibility and in the interest of efficiency, he should run it as independently as is reasonable.

Workers in each area should operate as a team and should be encouraged them to think of themselves as a team. Matters in each area are often interrelated so cooperation and free exchange of information between team members will result in the quickest and best examination. Morale will be higher if they think of themselves as a team with a common goal. It goes without saying the team members should be located in close physical proximity to each other.

The primary work product of the examiners will be written reports but the primary goal of the project is to analyze and summarize the contents of the reports so the properties can be evaluated and any objections to title can be submitted to the seller. Procedures must be established for the orderly accumulation and analysis of the reports and for incorporation of the information they contain into notices of objections to the seller (often referred to as the deficiency letter). Procedures must also be established for furnishing copies of the reports to the appropriate departments if they are to be used in incorporating the properties into the buyer's operations.

You should establish a team to accumulate and analyze title reports and prepare the written objections to the seller. In a small project, the project manager may be able to do this himself. In a larger project, the team may consist of the manager and various area leaders. In a massive project, it may be necessary to assemble a team with this as its sole task.

In summary, the following list enumerates some of the duties of the project manager: 1. Plans the examination.
2. Selects personnel and instructs them as to their duties.
3. Delegates duties to others.
4. Supervises and directs the effort.
5. Monitors the progress of all facets of the examination.
6. Confers with the buyer's management and keeps them informed as to the status of the examination.

7. Answers endless questions.
8. PUTS OUT BRUSH FIRES.

CHAPTER TEN

PRE-CLOSING

The term "pre-closing" covers matters that should be completed prior to closing. They can be divided into the following two categories:

1. Matters that must be completed prior to closing.
2. Matters that will lead to a speedy and efficient closing.

Matters That Must Be Completed Prior To Closing

The first category includes matters that must be completed prior to closing in order to satisfy the terms of the purchase and sale agreement. The first and most obvious step is the submission to the seller of the buyer's objections to title. As used herein, the term "objections to title" is an all inclusive term which includes all of the buyer's objections of every type and nature allowed under the purchase and sale agreement.

The next step is the seller's response to the buyer's objections to each property. The seller will cure them and provide the curative material to the buyer, respond that they are not significant or meaningful objections within the terms of the agreement or, if the agreement so provides, elect to not cure them and allow the buyer to drop that property from the transaction. The seller may point out that although a defect can be cured, it cannot be cured before the closing date and, if the agreement so provides, ask for a delayed closing date with respect to that property.

The buyer will evaluate the seller's curative material or other response to each objection and plan his course of action. He will then inform the seller of his decisions. The next step is for the buyer and seller to meet and attempt to agree on the disposition of each defect. This is a critical step because if the parties reach an impasse on a matter, it can lead to hard feelings and possibly to a lawsuit. It is important for the parties to work as hard as they can to reach a reasonable agreement because a lawsuit is expensive, time consuming and the verdict may be something that neither party wanted in the first place. Also, the parties are going to have to work together and cooperate on matters after the closing. If they have hard feelings toward each other, the smallest molehill can become a mountain.

As a matter of necessity, the purchase and sale agreement must provide deadlines for presentation of objections and curative material. However, it is not in the interest of either party to wait for these dates to provide his information to the other party. The buyer will be developing his objections as he proceeds through his due diligence examination so he can provide the seller with either final or preliminary objections as the examination progresses. The seller can begin his curative work as soon as he receives the buyer's objections.

It will take time for the seller to evaluate the buyer's objections and take steps necessary

to cure them. Some matters may take a considerable amount of time to cure so the seller needs all the lead time he can get. Likewise, it will take time for the buyer to evaluate the seller's curative material. Therefore, the parties should begin providing information to each other at the earliest possible time and negotiating as to the validity of the objections and the curative material. If you begin working with the other side as quickly as possible, many problems will be solved before any of the critical dates occur.

You should carefully review the purchase and sale agreement to determine whether there are any other matters that should be dealt with prior to closing.

Issues may arise that are not provided for in the purchase and sale agreement. In that event, it will be necessary for the parties to negotiate a solution and enter into a supplemental agreement.

Prior to closing, the buyer should plan the manner in which he will transport, store and incorporate the seller's records into his own record keeping system. His employees should be aware that the records will be arriving and have planned the manner in which they will handle and incorporate them into their respective departmental record systems.

Matters That Will Lead to a Speedy and Efficient Closing

The second category includes matters that will lead to a speedy and efficient closing. The parties should attempt to accomplish as much as possible prior to the actual closing. If this is properly done, the closing can be literally reduced to nothing more than the exchange of documents and money.

The purchase and sale agreement will usually provide forms for conveyances such as assignments of oil and gas leases, deeds for conveyance of properties owned in fee simple, bills of sale for personal property and descriptions of the properties to be used in the conveyances. However, it is not unusual for the parties to wish to make changes in the form of an instrument or changes in the descriptions of various properties. There may be matters such as mortgages and security agreements for which releases must be delivered at closing. Other instruments will also be necessary for the orderly transfer of ownership such as transfer orders to oil and gas purchasers or letters in lieu of transfer orders and notices or applications to regulatory agencies regarding the transfer of operatorship. There is always the question of the proper parties to execute such instruments. Forms for the instruments to be used should be reviewed and approved by both parties prior to closing. Both parties should also agree as to the proper persons to execute the instruments. Each side should execute documents in advance and be prepared to take the signed documents to the closing.

The purchase and sale agreement probably will not provide for detailed procedures for the transfer of possession and operation of the properties. Prior to closing, the parties should agree upon the manner in which the properties will be turned over to the buyer.

It is a good idea for the parties to prepare and agree upon an agenda for the closing. It will list the acts to be performed at closing and the documents to be delivered. The agenda will serve two purposes. First, the acts of preparing and reviewing it will cause everyone to review

the documents and make sure that no necessary documents have been omitted. It will also serve as a checklist at closing so the parties can ensure that the necessary documents have been delivered.

CHAPTER ELEVEN

CLOSING

If the transaction has been pre-closed and the documents executed in advance, the actual closing will amount to little more than the exchange of documents and the consideration. A properly pre-closed closing is an anticlimax. All that will be required is for each party to deliver the appropriate documents and for the receiving party to review them to confirm they are in the proper form and that they have been properly executed. Each document should be checked off on the closing agenda or some other form of master list as it has been delivered and reviewed.

If the documents have been reviewed, approved and executed prior to the closing, there will not be a need for attendance by persons with decision making authority or with the legal power and authority to execute documents of conveyance. However, it is a good idea to have such persons readily available in case last minute questions or problems arise. If the transaction has not been pre-closed, it will be necessary for the appropriate executives of the seller and buyer to attend the closing and to execute the documents.

CHAPTER TWELVE

POST-CLOSING

Many things will have to be done after the closing. A post-closing check list should be prepared that lists all of the items you need to do and check them off as they are done. You should appoint one person to be responsible for seeing that all the post closing acts are timely performed. In a large project, it may be necessary to establish teams to perform the various post closing tasks just as you established teams to perform the due diligence search.

Many post-closing tasks have been discussed in preceding chapters. Therefore, this chapter will simply mention a few highlights of the post-closing procedure.

The buyer should promptly file all documents of conveyance in the appropriate recording offices. You may wish to confirm that the documents have been properly filed and indexed by performing a record check or a supplemental title examination. This will also confirm that no intervening instruments have been filed of record.

The buyer will take actual physical possession of the properties and take over operations where appropriate. This requires coordination and cooperation between the buyer and the seller because operations should not be interrupted.

The files and other records of the seller must be delivered to the buyer and the buyer must make arrangements to transport them to his offices and to incorporate them into his operations. This deceptively simple observation includes everything from file folders to computer lease and accounting records to equipment inventories. You should also make sure that copies of the various reports you prepared when examining the seller's titles and properties are delivered to the appropriate departments. They will be an invaluable aid in incorporating the properties into the buyer's operations and record keeping system.

There may be properties for which closing has been delayed. It will be necessary for both parties to diligently pursue actions necessary to complete the closing as to these matters.

There may be many matters where the buyer and seller must work together until operations can be transferred to the buyer. For example, it will probably be necessary for the seller to continue accounting and disbursement functions (possibly for a fee) until the buyer can incorporate the records into his system and commence these functions.

There will be many notices that should be jointly issued by the buyer and seller to third parties such as transfer orders or letters in lieu of transfer orders, notices or applications to regulatory agencies regarding changes of operatorship or notices to operators or other third parties under agreements such as operating, participation or farmout agreements. Ideally, these will have been prepared prior to closing and delivered as part of the closing but as a practical

matter there may be many that still remain to be executed and submitted to third parties.

A final post-closing accounting will also be required to make adjustments for matters such as moneys received or disbursed by one party but for which the other party is entitled to receive credit under the purchase and sale agreement. Another typical matter is purchase price adjustments for properties for which closing has been delayed.

EXHIBIT A

SAMPLE TITLE OPINION FORMAT

John Doe
Attorney at Law
600 N. Park
Oklahoma City, OK 73100
(405) 555-1234

September 5, 2006

Prudent Oil Company
100 W. Main, Suite 1101
Oklahoma City, OK 73100

Attn: Jennifer Johnson, Land Manager

Re: Special #2-36 Well
SE/4 SE/4 of Section 36-7N-21E, containing 40 acres, more or less.
Mother Lode Field
Latimer County, Oklahoma
Seller Petroleum Company Acquisition
Inventory No. (From Exhibit Page)

ACQUISITION TITLE OPINION

Gentlemen:

Pursuant to your request we have examined the items noted on page nine hereof and any materials noted herein for the limited purpose of determining the interest of Seller Petroleum Company (SPC) in the above described property. From such examination we find that as of (date) at approximately (time) _.m., which is the date and time of our examination of the records of _____ County, Oklahoma, the interest of SPC is as follows, subject to the comments, objections and requirements herein set forth:

WORKING INTEREST

NOTE: All Mineral interests are unleased below the top of the Second Wilcox Sand. (Sample note for an absolute depth limitation. Where the Division Order

Title Opinion (DOTO) is limited or there are other limitations, use a note such as "Limited to production from the Soandso Formation.)

TRACT 1: S/2 SE of Section 36-7N-21E, containing 20 acres, more or less. (Use where SPC interest can be determined on a tract by tract basis. The fractions below were obviously not done on a tract by tract basis, so if this was a real calculation, each line would have to have a 20/40 multiplier added to the fraction.)

I. Above the depth of 10,000 feet (Use where ownership is different for different depths.)

A. Before payout (Use where BPO and APO are different.)

Lease No.	OWNER	FRACTION		NRI DECIMAL	OPERATING RIGHTS
1	Seller		50% x 31/32 x 13/16		
	Petroleum	less	50% x 6.25 % x		
	Company		31/32 ORRI	.3632813	.4843750

OVERRIDING ROYALTY INTEREST

(Use if SPC owns an ORRI. Same column headings, same breakdowns as WI if depth limited, APO/BPO, etc.)

FEE INTEREST

(Use if SPC owns a mineral or surface interest. Same column headings, same breakdowns as WI if depth limited, etc.)

TOTAL INTEREST OF SPC

(Use where different tracts, WI, ORRI, fee interests, etc. to show the total interest. Use same breakdowns if depth limited, APO/BPO, etc.)

INTEREST	NRI DECIMAL	OPERATING RIGHTS
Working Interest	.3632813	.4843750
Overriding Royalty Interest	.0001234	
	.3634047	.4843750

OIL AND GAS LEASES:

SPC (or other entity holding title) has an interest in the following leases. We have not examined the leases and have merely copied the tabulations from prior title opinions. (If we have examined and/or copied leases, change to something like: We have examined the leases as they appear in the county records and copies of same are submitted herewith. Or, where there are numerous leases and listing all of them would be a meaningless exercise, use something like: We have attached a copy of the Exhibit "A" pages for the Special #2-36 well from your Purchase and sale Agreement which lists the SPC leases covering captioned premises.)

1.	Dated:	April 14, 1981
	Recorded:	May 6, 1981 at Book 123, Page 456
	Lessor:	Sam T. Lessor and Sadie Q. Lessor, husband and wife; and Bill N. Lessor and Betty Lessor, husband and wife, and Mary Lessor, a single person.
	Lessee:	Harry Wilson
	Description:	S/2 SE (Tract I of the DOTO)
	Interest covered:	All mineral interest in Tract I
	Term:	Three (3) years
	Delay Rental:	Paid-up lease
	Depository:	None shown
	Royalty:	Three-sixteenths (3/16)
	Shut-in Gas Clause:	Yes (Add more if needed. For example, if clause is $200.00 per acre, say See special provisions and describe it there.)
	Pooling Clause:	Yes, oil 40 acres, gas 640 acres.
	Entirety Clause:	No.
	Special Provisions:	None. (List if just a few, otherwise something such as "This lease contains many special provisions. See Objection and Requirement No. 1.)

ASSIGNMENTS OF OIL AND GAS LEASES:

The following assignments which affect the interest of SPC appear of record and were not shown in the prior title opinions:

1.	Assignor:	Seller Petroleum Company
	Assignee:	Oil Well Investments, Inc.
	Dated:	August 18, 1989
	Recorded:	September 9, 1989 at Book 345, Page 77
	Interest Assigned:	Undivided 1/2 of Assignor's interest in Lease No 1.
	Special Provisions:	Limited to the borehole of the Special #2-26 well. Assignor

reserves the preferential right to purchase all oil produced from captioned premises which is attributable to the assigned lease. Subject to provisions of the farmout agreement between Assignor and Assignee dated May 31, 1989. Contains 30 day reassignment prior to surrender clause.

ENCUMBRANCES (NEW):

The following encumbrances are shown which are subsequent to those shown in the prior opinions:

MORTGAGES:

1. A mortgage is shown at Book 777, Page 888, dated October 23, 1990, recorded October 30, 1990, from Seller Petroleum Company to The Imaginary Bank. It secures the principal amount of $37.00 which is due on August 30, 1994 and covers all of the Mortgagor's interest in captioned premises.

2. UCC Financing Statement No. 12345 appears of record at Book 400, Page 599, recorded October 30, 1990, from Seller Petroleum Company to The Imaginary Bank, which covers all of the first party's interest in personal property and production from captioned premises.

PENDING SUITS AND JUDGMENTS:

No judgments or notices of lis pendens against the following parties are shown in the tract index for captioned premises or in the County Clerk's judgment docket. (Include predecessors in title or former company names of the seller since the date of the last title opinion that contained a court search.)

Great Production Company
Seller Oil Company, Inc.
Seller Petroleum Company

LIENS:

No liens were shown in the tract index or in the County Clerk's mechanic's and materialmen's lien docket against the above named parties.

COMMENTS:

1. This opinion is subject to the comments appearing in the prior title opinions.

2. This examination does not cover rights of which possession might be notice, or orders, rules and regulations of governmental agencies, or mechanic's, materialman's or laborer's liens, or future installments of assessments or liens of the Federal or State governments or any other claim not shown of record in the County Clerk's tract index for captioned premises or in the County Clerk's judgment docket; nor can we certify as to the identity, competency or majority of persons executing the instruments examined. We have made no investigation of environmental matters. You have provided us with copies of prior title opinions and requested that we rely upon them in preparation of this opinion. However, we cannot certify as to the accuracy of opinions prepared by other parties.

3. We have not searched the County Clerk's UCC records for matters not shown in the tract index; the District Court Clerk's records; the county tax records; or the Oklahoma central UCC filing record in the office of the County Clerk of Oklahoma County, Oklahoma.

4. We have not been furnished with a Certificate of Search by the Clerk of the Federal Court, and therefore do not certify as to the absence of liens or filings in that court. However, as no notice of any pending Federal Court suit or judgment has been filed in the office of the County Clerk of _____ County as required by law, you may waive this comment.

5. If you are unsure of the exact acreage covered by your oil and gas leases you should obtain a competent engineering survey covering captioned premises.

6. In our preparation of this opinion we have followed the current Title Examination Standards of the Oklahoma Bar Association. Acts of the Oklahoma Legislature have been assumed to be constitutional.

7. The interest of SPC in captioned premises may be subject to the provisions of joint operating agreements, farmout agreements, gas purchase contracts, etc. You have informed us that you are covering such matters in your in-house due diligence search. Therefore, we have made no mention of such matters unless they were addressed in the prior title opinions or appeared in the materials examined in our title search.

8. (Sample for spacing or increased density orders, if known) The Division Order Title Opinion of October 7, 1987 contained the following statement with regard to spacing:

> You have provided us with a copy of Oklahoma Corporation Commission Order No. 123456 (CD No. 12345), dated May 5, 1985, which creates 40 acre drilling and spacing units for production from the Tom, Dick and Harry formations underlying Section 36-27N-8W.

9. (Sample for completion report if known) The Division Order Title Opinion of October 7, 1987 contained the following well information:

> You have provided us with a copy of Oklahoma Corporation Commission Completion Report (Form 1002A) for the Northcutt #1-36 well. The report shows that drilling was started on June 20, 1987, that drilling was finished on July 23, 1987, and that the well was completed on July 30, 1987 as an oil well producing from the Tom formation. The well was located 2,640 feet from the South line of the quarter section and 1,320 feet from the West line of the quarter section.

10, etc. (Reiterate any applicable info on Oklahoma Corporation Commission force pooling orders, increased density orders, location exception orders or other matters such as BLM or BIA communitization agreements.)

OBJECTIONS AND REQUIREMENTS:

Requirements one through eight refer to those appearing in the Division Order Title Opinion of October 7, 1987. Requirements that on their face do not appear to affect the interest of SPC have not been reiterated.

REQUIREMENT No. 1:

Advisory. This requirement directed your attention to the special provisions contained in Lease No. 1. You should familiarize yourselves with all of the provisions of said lease and conduct your operations accordingly.

REQUIREMENT No. 6:

(a) Not satisfied. This requirement directed your attention to the mortgage from Sam T. Lessor and Sadie Q. Lessor, his wife, to The Federal Land Bank, dated September 9, 1980, recorded at Book 395, Page 333, which was briefed in the Division Order Title Opinion. The mortgage is superior to Lease No. 1. The prior examiner called for you to secure and file of record a subordination agreement which subordinates the mortgage to Lease No. 1. The required subordination agreement has not been filed of record.

(b) Both the mortgagors and the mortgagee should execute your division order directing the manner and method of payment of royalties attributable the interest of the mortgagors under Lease No. 1. We do not know whether this requirement has been satisfied.

(Some sample new objections and requirements)

OBJECTION No. 9 (New):

The Purchase and sale Agreement Exhibit A page for the Special #2-36 well shows that SPC has a Working interest of 48.4375000% and a Net Revenue Interest of 36.3281300%. Our findings agree with these amounts. (Or, describe differences and explain if possible.)

REQUIREMENT No. 9 (New):

Advisory (If findings agree)

You should further investigate the reason for these differences, etc. (If findings do not agree)

OBJECTION No. 10 (New):

With regard to the Mortgage and UCC financing statement from SPC to The Imaginary Bank which are briefed herein under Encumbrances:

REQUIREMENT No. 10 (New):

Said mortgage and financing statement should be released of record unless you are acquiring the interest of SPC subject to them.

OBJECTION No. 11 (New):

We have assumed that the oil and gas leases covering captioned premises have been perpetuated by production.

REQUIREMENT No. 11 (New):

You should assure yourselves that our assumption is correct.

OBJECTION No. 12 (New):

Record title to Lease No. 1 is still in Great Production Company. (In this example, SPC is the successor to Great Production Company and Seller Oil Company, Inc. by corporate change of name or merger.)

REQUIREMENT No. 12 (New):

(a) An appropriate assignment or certificate of corporate change of name or merger should be filed of record in _____ County and indexed against captioned

premises.

(b) In the alternative, pursuant to Oklahoma Bar Association Title Standard No. 9.4, the name of the grantor in the conveyance from SPC to you should be shown as Seller Petroleum Company, successor to Great Production Company and Seller Oil Company, Inc. by corporate change of name or merger.

OBJECTION No. 13 (New):

Lease No. 5 (BLM No. OK-12345) is a Federal lease (Indian lease, State lease, etc.). Pursuant to its provisions and the applicable regulations, any assignment must be on an official form and submitted to the BLM (or Department of the Interior, Commissioners of the Land Office of the State of Oklahoma, etc.) for approval.

REQUIREMENT No. 13 (New):

(a) Any assignment of Lease No. 5 should be made on the proper form and submitted to the BLM (Department of the Interior, Commissioners of the Land Office, etc.) for approval.

(b) It is our opinion that you should also file the approved assignment (or an appropriate duplicate assignment) in the county records to give additional constructive notice to third parties.

OBJECTION No. 14 (New):

Lease No. 5 (BLM No. OK-12345) is a Federal lease.

REQUIREMENT No. 14 (New):

We should be provided with a Federal abstract which is certified from _____, the date of certification of the last Federal abstract.

OBJECTION No. 15 (New):

The division of interest in the Division Order Title Opinion dated October 7, 1987 was limited to the Tom Formation. Our examination of the prior title opinions and subsequent instruments noted in the tract index do not indicate that this was the result of borehole or depth limited assignments. The Oklahoma Corporation Commission Order discussed under Comments established 40 acre drilling and spacing units for the Tom, Dick and Harry Formations. Therefore, it appears that the prior examiner stated that his opinion was limited to the Tom formation in order to reflect the division of interest in the spaced formation as opposed to production from any other formation that might have different spacing, and not as a

limitation on his tabulation of ownership.

REQUIREMENT No. 15 (New):

(a) Advisory.

(b) You may wish to make further inquiry of SPC regarding their knowledge of any depth limitations.

OBJECTION No. 16 (New):

Our search of the County Clerk's judgment docket is limited to the following names we listed under Pending Suits and Judgments. It will not include pending lawsuits or judgments not indexed in the docket or in the tract index for captioned premises. This search may not reveal judgments which were filed in the County Clerk's Office but not properly indexed prior to November 1, 1988.

REQUIREMENT No. 16 (New):

Advisory.

Respectfully submitted,

John Doe
Attorney at Law

Comment: Exhibit "A" will usually be a copy of the list of the oil and gas leases and the seller's interests copied from the exhibits to the Purchase and sale Agreement.

1. Original Title Opinion dated January 12, 1982 covering the SE/4 of Section 36-7N-21E, prepared by John Doe for benefit of Great Production Company, based on abstracts of title certified from inception to December 14, 1981 at 8:00 a.m.

2. Division Order Title Opinion for the Jones #1 Well, dated April 11, 1982, covering the SE/4 of Section 36-7N-21E, prepared by John Doe for benefit of Great Production Company, based on the prior title opinion, curative material, and upon abstracts of title certified from December 14, 1981 at 8:00 a.m. to March 28, 1982 at 8:00 a.m.

3. First Supplemental Division Order Title Opinion for the Jones #1 Well, dated June 4, 1982, covering the SE/4 of Section 36-7N-21E, prepared by John Doe for benefit of Great Production Company, based on examination of curative material.

4. Drilling Opinion for the Special #2-36 Well, dated July 12, 1987 covering the SE/4 SE/4 of Section 36-7N-21E, prepared by John Doe for benefit of Great Production Company, based on the prior title opinions and upon abstracts of title certified from March 28, 1982 at 8:00 a.m. to June 24, 1987 at 8:00 a.m.

5. Division Order Title Opinion for the Special #2-36 Well, dated October 7, 1987, covering the SE/4 SE/4 of Section 36-7N-21E, prepared by John Doe for benefit of Great Production Company, based on the prior title opinions, curative material, and upon abstracts of title certified from June 24, 1987 at 8:00 a.m. to September 22, 1987 at 8:00 a.m.

6. Copy of your in-house Due Diligence Report for the Special #2-36 Well.

7. Copy of your Purchase and sale Agreement Exhibit A page for the Special #2-36 Well.

8. Our examination of the instruments noted in the tract index for captioned premises and the judgment docket (for the names listed under Pending Suits and Judgments) in the Office of the County Clerk of _____ County, Oklahoma from September 22, 1987 at 8:00 a.m. to __(date) at approximately _(time)_ __.m.

EXHIBIT B

SAMPLE PROPERTY CHECKLIST

PROPERTY NAME: _____

PROPERTY CODE: _____

FIELD NAME: _____

OPERATOR: _____

WI: _____

NI: _____

STATE: _____

COUNTY: _____

DESCRIPTION: _____

_____

_____

DEPTHS CONVEYED: _____

LEASES: (Attach Contract and Lease Cross-Reference)

1.	All lease data sheets completed?	Yes	No
2.	All lease files found? (if no, attach copy of File Request List)	Yes	No
3.	Copies of all leases in file? (if no, attach copy of Request for Copy of Original Lease)	Yes	No
4.	Any federal leases? (if yes, mark federal leases F on Cross-Reference)	Yes	No

Any federal forms required? Yes No
If yes, are they complete? Yes No

5. Any state leases? Yes No
(if yes, mark state leases St on Cross-Reference)

Any state forms required? Yes No

If yes, are they complete? Yes No

6. Any Indian leases? Yes No
(if yes, mark Indian leases I on Cross-Reference)

Any Indian forms required? Yes No

If yes, are they complete? Yes No

CONTRACTS: (Attach Contract and Cross-Reference)

1. Completed Data Sheet for all contracts? Yes No

2. All contract files found? Yes No
(if no, attach copy of File Request List -
same list as to request lease files)

3. Any Preferential Right to Purchase (PRP)? Yes No
(if yes, list contract #: _____)

Are PRP letters prepared? Yes No

4. Maintenance of Unit Ownership? Yes No
(if yes, list contract #: _____)

Waiver of MUI? Yes No

5. Any Non-Consent penalties in effect? Yes No
(if yes, list contract #: _____)
(if yes, then _____ % / _____ % $ _____
to be recovered before payout as of _____ , 19 ___)

6. Any continuing obligations? Yes No
(if yes, list contract #: _____)

Describe the obligation: _____

_____

7. Any other restrictions to sale of this property (consent to assign, etc.)? Yes No
(if yes, list contract #: _____)

Describe the restriction: _____

_____

Has the restriction been waived? Yes No

OVERLAP:

Does this property overlap with other properties? Yes No
(example: by contract area, proration/spacing unit, lease description)

If yes, describe: _____

_____

DEPTH LIMITATIONS:

Does this property contain depth limitations and/or variations
of (company's) interest by depth? Yes No

If yes, describe: _____

_____

REVERSIONARY INTEREST:

Does (company) own any reversionary interest in the property? Yes No
(example: term mineral deed, BPO/APO, etc.)

If yes, describe: _____

_____

If reversion is subject to payout, what is the status?
$ _____ to be recovered before payout as of _____ , 19 __)

WELL INFORMATION:

How many wells in this property? _____

Is well information sheet complete? Yes No
(may not be necessary for each property)

REGULATORY ORDERS:

Is this property subject to any pooling order,
increased density or local exception order? Yes No

If yes, list orders:

Regulatory Authority	Type Order		Date	Order No.	CD No.

CALL ON PRODUCTION: **

Does (company) waive call on production? Yes No

INFORMATION IN PROPERTY FILE: (right side)

Dwights Production History _____
Lease Data Sheets _____
JOA and other Contract Data Sheets _____
Gas Contract Summary (Gas Brief) _____
Gas Balance Report _____
Ownership Report (Division of Interest) _____
Completed Description Page _____

INFORMATION IN PROPERTY FILE: (left side)

Completed Plat _____
Exhibit "A" _____
Reservations _____
Depths _____
Reference to JOA, etc. _____

PURGE AND COPY: **

Purge files:

Lease Yes No

Contract Yes No

Well Yes No

Have the necessary files been copied? Yes No

OPERATED PROPERTIES:

1. Change of Operator forms completed? ** Yes No

2. Materials List ** Yes No

3. Common facilities

   Are any facilities for this property associated with other properties? Yes No

   If yes, describe: _____

   _____

4. Environmental review? ** Yes No

5. Are any right-of-ways for this property associated with other properties? Yes No

   If yes, describe: _____

   _____

6. Are any other surface rights associated with this property other than ROWs? Yes No

*** A&D will handle***

EXHIBIT C

SAMPLE SYNOPSIS

Producing Property Number: _____

1. Type of interest: Mineral Royalty Overriding Royalty Net Profits

   If Overriding Royalty, what type: Level Sliding Scale Convertible

   Amount of interest shown by: _____

   Verified interest per due diligence review: _____

   When acquired: _____

   How acquired: _____

   Limitation on term of ownership: _____

   Restrictions on sale or other disposal, preferential right, consent to assign:

   _____

2. Lease/Royalty Number: _____

   What type of lease? Fee Federal State Indian

   Other: _____

   Brief of unusual lease provisions: _____

   _____

   Restrictions under lease on sale or other disposal? Yes No

3. Contract Number: _____

   What kind and types of contracts: _____

   _____

   Brief of contract provisions: _____

   _____

   Unusual contract provisions: _____

   _____

Restrictions under contract on sale or other disposal: _____

_____

Right to take in kind? Yes No

4. Division Order Number: _____

Operator of property: _____

Purchaser(s) of production: _____

_____

Who pays: Gas _____ DO# _____ Property # _____

Oil/Condensate _____ DO# _____ Property # _____

Type of production: Gas _____ Oil _____

Net Revenue Decimal: _____

5. Does price received for oil/gas appear reasonable? Yes No

Is any portion of this property in suspense? Yes No

Are there any discrepancies in ownership decimal? Yes No

6. Comments: _____

_____

_____

_____

_____

_____

_____

_____

_____

_____

Prepared by: _____

Date: _____

EXHIBIT D

SAMPLE DUE DILIGENCE CHECKLIST

LEGAL DESCRIPTION OF LANDS AND FORMATION COVERED BY THIS REVIEW: (Section _____ T _____ R _____)
(County _____ State _____)

Field Name: _____

Sellers Operator	Well Name	Legal	O/G	Formation	Producing NRI	Exhibit "A" - WI

SELLER TITLE INFORMATION: FILE NO.(S): _____

1. List dates of opinions and acreage examined: _____

2. Is scope of title opinion examination listed? Yes No

   If yes, describe: _____

3. Are there superior liens or mortgages to seller's interest? Yes No

   If yes, describe: _____

4. Please note any other unusual instruments in title which may adversely affect seller's title:

5. DESCRIBE STATE AUTHORITY FOR SPACING, VOLUNTARY UNIT, LANDS, DEPTH AND FORMATIONS: Note dates, recording data, order numbers, if producing on voluntary unit and attach copy.

Formations	Unit Size	Description of Unit

6. Seller's leases or unit interest created by: (circle each) oil & gas leases minerals forced pooling royalty overrides other: _____

7. What oil & gas leases does seller own: (circle each) fee federal state Indian

8. Note lease obligations and depth limitation: _____

_____

9. Note apparent HBP producing acreage outside producing unit: _____

_____

10. O/A or AMI: _____ Dated: _____ Operator: _____

Unit area description: _____

_____

Unit interest of seller: _____ % W.I.

Attach Change of Operator Notice Provision.

Preferential right to purchase? Yes No

Company(s): _____

Working interest owned: _____

Time to elect _____ after notice.

11. SELLER LAND CONTRACTS in file: (please note below)

Also complete the following:

12. Farmin or farmout/farmor: _____

Farmee: _____

Dated: _____

Significant terms of trade: (ORRI, backin, etc.)

(Note if borehole): Yes No

If yes, note depth interval and/or total depth earned: _____

_____

Seller: _____

BPO: _____ %

APO: _____ %

Call on oil & gas? Yes No

By whom? _____

Are there any reassignment provisions? Yes No

Oil: _____

_____

Gas:

If yes, note by whom: _____

Brief description of rights earned: _____

13. Note any Increase Density Order and/or Commingle Orders with Order #, CD #, formations:

14. State authority, if applicable, or forced pooling: CD # _____ Order # _____

Dated: _____ Are there force pool interests? Yes No

If yes, describe lands pooled, ORRI received and BI % _____

Note formations forced pooled: _____

(To evidence all contracts in unit, attach additional forms, if necessary)

DIVISION ORDER

15. Is seller's division of interest from division order the same as seller's interest noted in seller exhibit for each product and well? Yes No

List division of interest from division orders with purchaser's name and product:

Seller	Well Name	Oil	Gas	Purchaser	Net Revenue Interest	Working Interest

16. Does the seller disburse royalty? Yes No

Note disburser, if not seller: _____

17. Is seller's interest suspended? Yes No

18. Note any pending litigation and problem areas such as demand for development, notice of improper payment of royalty, shut-in payments, etc. or other unusual notices or correspondence.

19. Note other agreements such as surface, right-of-way, saltwater disposal and/or gas processing. Please note terms and if or when payments are required:

20. Attach Seller Chain of Title Worksheet, note special provisions from agreements and any special items of concern to buyer from seller's file and also comments with deficiencies noted in file:

21. Verify all information on assignment Exhibit "A". If different, note and explain:

Date: _____ File reviewed by: _____

EXHIBIT E

SAMPLE INSIDE EXAMINATION TITLE REPORT

Due Diligence Analysis Form
and Checklist on Producing Properties

For: _____

Deal: _____

Property name and location: _____

Prospect name: _____

Allocated value: _____

Represented interests: BPO APO
(per P & S Agreement) WI
NRI

Operating Agreement

Operator: _____

Date: _____

Contract area: _____

Working interest: _____

Preferential right stricken? Yes No

Violation of maintenance of uniform interest? Yes No

Unusual provisions adversely affecting decision to purchase? Yes No

Notes: _____

Unit

Lands utilized: _____

Zones utilized: _____

Substances unitized: _____

How created: _____

Notes: _____

Division Order Title Opinion

Does it cover the same lands and zones as the unit? Yes No

NRI: BPO APO

Unsatisfied requirements and percentages of total: _____

Interest affected: _____

Division Order

Purchaser: Oil: Gas:

NRI: Oil: BPO APO Gas: BPO APO

Unsigned D.O.S.: _____

Suspended interests: _____

Notes: _____

_____

Contracts

Consents to assign/preferential rights: _____

Terms adversely affecting title or unusually burdensome: _____

List of contracts: (gas contracts et al)

Agreement	Party #1	Party #2	Date
1.			
2.			
3.			

Tax partnership: _____

Lands covered: _____

Notes: _____

_____

Leases

All property described on Exhibit "A" of assignment:

Unusual provisions in leases or assignments (consents to assign, etc.):

Chain of title into seller complete: (you may rely on a title opinion if all instruments are not in the file.)

State and federal assignments approved:

Approved assignment form prepared for transfer to:

Notes:

Litigation/Demands

Yes:

Nature of demand:

Current status:

Percentage of interest affected:

State Filing

Current filing:

Type:

Unit acreage:

Description filed:

With state:

Unit changes:

General

Prepared by:

Date:

			WI		NRI						
Well Name	DO	DOTO	BPO	APO	BPO	APO	ORRI	Operator	Purchaser	Price	Remarks
Gas											
Oil											
Gas											
Oil											
Gas											

Oil											
Gas											
Oil											

EXHIBIT F

SAMPLE AGREEMENT OF PURCHASE AND SALE

THIS AGREEMENT made and entered into, by and between (company), a (state) corporation, with an office and place of business located at _____ (hereinafter sometimes called "SELLER"), and _____, a _____ corporation, having an office at _____ (hereinafter sometimes called "BUYER").

SELLER agrees to sell and BUYER agrees to buy, for the cash sum of _____ adjusted as provided in paragraph 17 below, the following described and referred to properties and interests which are together hereinafter sometimes referred to as the "Subject Interests":

All of SELLER's right, title and interest in and to

All of those properties, rights and interests described on Exhibit "A", attached hereto and made a part of hereof for all purposes, as limited on said Exhibit "A", and all personal property, improvements, moveables, easements, permits, licenses, servitudes, and rights-of-way situated upon or used or useful or held for future use in connection with the exploration, development, maintenance or operation of the properties, rights and interest described on said Exhibit "A".

Such purchase and sale is made and accepted upon the following terms and conditions:

1. SELLER's Representations: SELLER represents to BUYER:

(a) That, to the best of SELLER's knowledge, all oil and gas leases, contracts, licenses, easements, permits and other rights and interests comprising any portion of the Subject Interests are now and shall be as of the date of closing in full force and effect according to their respective terms and provisions and that all rights granted thereby are valid and subsisting, and SELLER has received no notices or demands affecting or relating to such rights.

(b) That, to the best of SELLER's knowledge, all payments of rentals, royalties, and other charges, if any, required by the terms and provisions of the oil, gas and mineral leases, contracts, licenses, permits and easements comprising any portion of the Subject Interests to be made prior to closing date to prevent forfeiture or termination thereof shall have been fully and timely paid.

(c) That SELLER has caused no lien to attach to any of the Subject Interests.

(d) That SELLER has full power and authority to enter into and perform its obligations under this Agreement and has taken all proper corporate action to authorize entering into this Agreement and the performance of its obligations hereunder.

(e) That the conveyance and assignment from SELLER to BUYER of the Subject Interests will contain no warranty of title to the Subject Interests, either express or implied. SELLER warrants that Subject Interests have not been sold, disposed of or mortgaged by SELLER.

2. BUYER's Representations: BUYER represents to SELLER:

(a) That BUYER is negotiating this transaction and entering into this contract for its own account.

(b) That BUYER has the funds necessary to fully pay for the Subject Interests and to pay any settlement amounts at closing.

(c) That BUYER has obtained all necessary authority to enter into and to consummate this contract.

(d) That BUYER will promptly cooperate in the closing of the transaction evidenced hereby after being informed by SELLER that the papers necessary for such conveyance have been prepared.

3. BUYER's Conditions to Closing: The obligation of BUYER under this Agreement to purchase the Subject Interests shall, at BUYER's option, be conditioned upon the following:

(a) SELLER shall have performed all of the terms and provisions contained in this Agreement to be performed by SELLER.

(b) At the date of closing, no suit or other proceeding shall be pending or threatened in which it is sought to restrict or prohibit the consummation of the sale of the Subject Interests as contemplated by this Agreement or in which title of SELLER to a substantial portion of the Subject Interests is brought into question.

4. Records, Contracts and Files: If requested by BUYER, all original lease and land records, and all existing contracts, well files, including all well logs, core analyses, drilling records, and all other materials pertaining to the Subject Interests in possession of SELLER and copies or duplicates of which BUYER does not have shall be delivered to

BUYER and, as of closing, shall become the property of BUYER as a part of the Subject Interests. SELLER may make and retain copies of all or any part of such items. BUYER shall provide access to and/or copies of all data, information and documents covered by this Agreement to SELLER.

5. Title Information: Upon request, SELLER shall make available to BUYER such title information as SELLER has. Existing abstracts will not be brought down to date by SELLER.

6. Taxes: Property and/or ad valorem taxes assessed against the Subject Interests for the year 19___ (even though such taxes may be based on the preceding year's production) shall be prorated to _____, 19___, with SELLER paying that proportion of the year's taxes accruing before such date and BUYER paying that proportion of the taxes accruing on and after such date. BUYER shall be responsible for and shall pay all taxes from _____, 19___, forward. Any sales taxes, transfer taxes or fees due as a result of this sale shall be paid by BUYER. BUYER agrees to pay SELLER the amount of any deficiency, additional tax, interest and penalty assessed against SELLER by the taxing authority as a result of this sales transaction.

7. Conditions and Covenants: BUYER agrees that from and after the Effective Date, hereinafter noted, it will assume and carry out all conditions and covenants and obligations contained in the leases, contracts, licenses, easements and permits comprising the Subject Interests. SELLER declares that, to the best of its knowledge, such conditions, covenants and obligations have been fully complied with and performed down to the Effective Date hereinafter noted and agrees to hold BUYER harmless from any claim or judgement arising out of SELLER's failure to so comply with and perform any such conditions, covenants and obligations with which SELLER was legally obligated to comply or as to which SELLER was legally obligated to perform.

8. Effective Date: The conveyance and assignment of the Subject Interests to BUYER shall be effective as of 7:00 a.m., C.T. on _____, 19___, herein defined as the "Effective Date".

9. Oil and Liquids in Tanks and Pipelines and Gas: All oil and liquids in the lease tanks and pipelines shall be gauged as of 7:00 a.m., C.T., on _____, 19___, and all merchantable oil and liquids in the tanks and pipelines as of that time and date shall belong to SELLER. BUYER shall be obligated to compensate SELLER for such oil and liquids as hereinafter provided in paragraph 17.

   Subject to paragraph 22 below, all gas produced and saved up to said Effective Date shall belong to SELLER. All gas produced and saved after such Effective Date shall belong to BUYER.

10. Oil and Liquids Produced After Effective Date: SELLER shall pay to BUYER the amounts received by SELLER for all oil and liquids produced from the Subject Interests

after 7:00 a.m., C.T., on _____, 19___, and for which SELLER has received run checks. All oil and liquids produced and saved after the Effective Date shall belong to BUYER.

11. Closing Date: This purchase and sale shall be consummated and closed on or before _____, 19___, in SELLER's _____ office.

12. SELLER's Covenants Pending Closing: Between the date hereof and the closing date, SELLER agrees that:

    (a) SELLER will do nothing to jeopardize the validity of the Subject Interests.

    (b) Without the written consent of BUYER, SELLER will not enter into any new agreements or commitments with respect to any Subject Interests, except such agreements, commitments and spot sale agreements as are in the opinion of SELLER reasonably required for the operation thereof.

13. Operation of the Subject Interests: All costs and expenses of the operation and insuring of the Subject Interests after the Effective Date, including royalty payments, shall be charged to the account of BUYER and shall be paid solely by BUYER.

14. Delivery of Assignment, Records, Contracts and Files: At the time of closing, or as soon thereafter as possible, SELLER shall deliver to BUYER all records, contracts, files and other materials herein required to be furnished and delivered by SELLER and which have not already been so delivered to BUYER. At closing, SELLER shall then deliver to BUYER instruments of assignment and conveyance covering all of the Subject Interests duly executed and acknowledged on behalf of SELLER without warranty of title, express or implied.

15. Payment of Purchase Price: At the time of closing, BUYER shall have paid over and delivered to SELLER in lawful funds of the United States of America _____ by wire transfer to SELLER's account.

16. Delay Consideration: Notwithstanding any other provisions herein to the contrary, in the event that BUYER delays closing this transaction, for any reason, beyond _____, 19____, then it shall pay to SELLER as delay consideration for such delay, One Thousand Dollars ($1,000.00) per day for each day after _____, 19___, and before the date of actual closing, that BUYER cannot or will not close this transaction. This amount is not a penalty, but is liquidated damages to compensate SELLER for the loss of the time value of money.

17. Adjustment of Purchase Price: The purchase price of the Subject Interests shall be subject to the adjustment, as hereinafter provided. After the adjustment has been made pursuant to a final accounting, then any net sum due BUYER shall be paid to BUYER by

SELLER and shall represent a reduction in the purchase price. Any net sum due SELLER will be paid to SELLER by BUYER and shall represent an increase in the purchase price.

The adjustment hereinabove discussed shall be determined by a final accounting as follows:

(a) Sum Due SELLER: SELLER shall be entitled to receive from BUYER the aggregate of:

(1) All sales and/or excise taxes, transfer taxes or fees assessed as a result of the sale of the Subject Interests which have been paid by the SELLER. All windfall profit taxes paid by SELLER on BUYER's oil and liquids.

(2) All costs and expenses associated with the operation and insuring of the Subject Interests after such Effective Date and which SELLER has paid or will pay, as hereinafter discussed in paragraph 13.

(3) The amounts received by BUYER from the sale of SELLER's gas and/or oil and liquids or the fair market value of any such minerals produced from the Subject Interests prior to the Effective Date and remaining unsold.

(4) Delay consideration, if any, as discussed in paragraph 16 hereinafter.

(5) Property and/or ad valorem taxes for _____ assessed against the Subject Interests on and after the Effective Date, if such taxes were paid in advance.

(b) Sum Due BUYER: BUYER shall be entitled to receive from SELLER the aggregate of:

(1) Property and/or ad valorem taxes for _____ assessed against the Subject Interests up to said Effective Date, if such taxes are to be paid after closing. All windfall profits taxes paid by BUYER for SELLER's oil and liquids.

(2) The amounts received by SELLER for all oil and liquids and/or gas produced and saved from the Subject Interests after such Effective Date, and for which SELLER has received run checks.

The sum due SELLER shall be compared to the sum due BUYER. The smaller of these two sums shall be deducted from the larger thereof, and the net amount remaining after such deduction shall be due, in cash, to either SELLER or BUYER, as the case may be. The final

accounting shall be conducted by SELLER's and BUYER's accountants as soon after closing as possible. The party owing a net sum to the other shall immediately pay such sum upon notification that the sum is due.

18. Negotiation of This Purchase and Sale: Each party represents that it has negotiated this transaction only through its own personnel and has incurred no obligation to any agent or broker for any commission in connection with this transaction. Each party agrees to indemnify and hold harmless the other for the indemnitor's breach of this paragraph.

19. Good Faith Negotiations/FERC Order 451: To the extent any of the Subject Interests is subject to a commitment to sell any production to a purchaser under a gas purchasing agreement which includes any gas categorized as Section 104 and/or Section 106 under the Natural Gas Policy Act, the following shall apply:

(a) SELLER excepts and reserves the right to initiate "good faith negotiation procedures" as to the Subject Interests pursuant to Order No. 451 of the Federal Energy Regulatory Commission (FERC), and 18 C.F.R. §270.201, et seq. BUYER specifically understands that it will have no right to invoke good faith negotiations with respect to the Subject Interests.

(b) If SELLER, at any time hereafter, initiates "good faith negotiation procedures" for any gas sold under any "existing contract" (as that term is defined in Order No. 451) with the same purchaser to whom the Subject Interests are currently dedicated, the purchaser will have the right to require BUYER to renegotiate terms of the sale of production from the Subject Interests, consistent with the provisions of 18 C.F.R. ¶¶270.201 (b)(2) and (b)(5)(ii), as promulgated by Order Nos. 451 and 451-B; and such right of said purchaser is unaffected by this assignment. However, nothing herein shall limit or abridge BUYER's right to determine, in its sole discretion at negotiations, acceptable terms and conditions of continuing the sale to purchaser of production from the Subject Interests.

(c) BUYER shall have no right or power to take any action, by amendment, waiver or otherwise, that would limit, modify, abridge, or terminate SELLER's right to initiate the "good faith negotiation procedure" as to any of its existing contracts with the same purchaser to whom the Subject Interests are currently dedicated. Nothing herein shall obligate SELLER to initiate, or refrain from initiating, such "good faith negotiation procedures." Nothing herein shall limit or affect SELLER's right to determine, at its sole discretion, acceptable contractual terms and conditions when conducting such "good faith negotiation procedures", and SELLER shall have no duty, obligation or liability to BUYER with regard to the outcome of BUYER's good faith negotiations with the purchaser of production from the Subject Interests.

(d) BUYER shall expressly protect and maintain SELLER's rights under this

paragraph in any re-assignment of the Subject Interests. BUYER agrees to indemnify and hold harmless from and against any and all loss, cost and expense, including reasonable attorneys' fees, incurred as a result of BUYER's failure to comply with this paragraph and to adequately protect SELLER.

20. Take-and-Pay or Take-or-Pay Crediting: Prior to any transportation of natural gas produced from any of the Subject Interests that could render any such gas subject to the take-or-pay or take-and-pay crediting mechanism imposed by statute or regulation (such as that promulgated by the Federal Energy Regulatory Commission's (FERC) Order Nos. 500, et seq.), BUYER shall attempt to obtain a waiver by the potential pipeline transporter(s) of such pipeline's rights to invoke any provision of such crediting mechanism against SELLER or any properties owned by SELLER on June 23, 1987 or thereafter. If such waiver of crediting rights is not agreed to by such pipeline transporter(s), BUYER shall not cause transportation to commence without the prior written consent of SELLER. Said prior consent shall not be unreasonably withheld but SELLER shall have no obligation whatsoever to offer credits which will cause actual crediting against its take-or-pay or take-and-pay contracts. BUYER shall not allow take-or-pay or take-and-pay credits it has granted to any pipeline to be used against SELLER's take-or-pay or take-and-pay claim under the contract for the Subject Interests. BUYER shall expressly protect and maintain SELLER's rights under this paragraph in any re-assignment of the Subject Interests. BUYER shall indemnify SELLER against all loss, cost and expense, incurred by SELLER as a result of BUYER's failure to comply with this provision.

21. Entire Agreement: This Agreement contains the entire agreement between the parties hereto with respect to the transaction covered hereby and supersedes all prior agreements between the parties, oral or written, relating to the subject matter of this Agreement. This Agreement shall extend to and be binding upon the successors and assigns of the parties hereto. An assignment shall be executed in consummation of this Agreement. Any conflict between said assignment and this Agreement shall be resolved in favor of this Agreement.

22. (INSERT A PROVISION HERE CONCERNING GAS PRODUCTION IMBALANCES IN ACCORDANCE WITH THE PARTICULAR SITUATION.)

23. Miscellaneous:

(a) The personal property, improvements and moveables included in the Subject Interests are to be conveyed without any warranties, expressed or implied, as to quality, merchantability or fitness for use of a particular purpose. Additionally, such items will be conveyed "as is" and "where is".

(b) BUYER agrees to indemnify and hold SELLER harmless from any and all claims, attorneys' fees, demands, costs, causes of action, suits, fines, damages, rulings

and judgements accruing on and after the closing date and based on or in any way related to the use, operation, installation, removal or maintenance of the personal property, improvements and moveables included in the Subject Interests.

(c) BUYER agrees that, upon the closing of this transaction, it solely assumes the firm obligation to properly and promptly plug and abandon all wells needing such operations and located on the Subject Interests or on lands pooled therewith.

(d) BUYER shall fully comply with all rules, regulations, orders, laws and rulings with respect to the Subject Interests and agrees to indemnify and hold SELLER harmless from any attorneys' fees, costs, fines, orders, rulings, judgements, or damages accruing on and after the Effective Date and resulting from BUYER's failure to so comply.

(e) BUYER shall fully comply with all terms, covenants and conditions of the oil, gas and mineral leases included in the Subject Interests and all related documentation and agrees to indemnify and hold SELLER harmless from all claims, demands, fines, attorneys' fees, judgements and damages accruing on and after the Effective Date and resulting from BUYER's failure to so comply.

(f) BUYER hereby agrees to indemnify and hold harmless SELLER from all attorneys' fees, costs, fines, damages, claims, judgements and losses, accruing on or after said Effective Date, and resulting from, arising out of or associated with BUYER's acts or omissions as to the Subject Interests, or any part thereof whether due to negligence or gross negligence (whether sole or concurrent), willful misconduct or violation of statutory and regulatory law (both state and federal).

(g) The conveyance of the Subject Interests shall be made specifically subject to any and all conveyances, reservations and matters of record in County, _____, even though such conveyances, reservations and matters are not specifically recited herein or in said conveyance, to any gas purchase contracts, farmout agreements, operating agreements and contracts currently in force as to the Subject Interests, if any, and to all non-consent elections by SELLER or its predecessors-in-interest.

(h) BUYER hereby releases SELLER from all causes of action based on deceptive trade practices acts or similar laws as to the Subject Interests or any part thereof.

(i) The parties will take such further actions and will do such further things as are reasonably required to carry out the letter and spirit of this Agreement.

(j) Each party shall be responsible for its expenses as to this purchase and sale

agreement.

This instrument is signed and effective this _____ day of _____, 19___.

WITNESSES: **

_____

_____

_____

SELLER:

By _____

Title _____

BUYER:

By _____

Title _____

(ACKNOWLEDGEMENTS)

** Witnesses are required for execution of Louisiana documents.

BIBLIOGRAPHY

The following works contain useful information on the subject of acquisition and divestment. There are many other works that contain valuable information, but the listing has been primarily limited to publications which are readily obtained by the reader. Therefore, materials such as papers that were presented at seminars and were not published in periodicals or are not otherwise readily available have not been included in the listing. Apologies are extended to the authors of such fine works that are not included herein.

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2. Bryant, Ira H. (Stormy) III, *The Oil and Gas Due Diligence Title Search,* The Landman, March/April 1991.

3. Campbell, Bert L., et al., *Management of Title Review, Due Diligence, and Other Legal Tasks in Large Oil and Gas Transactions,* 31st Rocky Mountain Mineral Law Institute 16-1, 1985.

4. Clark, Bernard F., Jr., *Environmental Due Diligence: Birth of the Environmental Landman,* The Landman, May/June 1992.

5. Davis, Gary W. and Christiansen, Mark D., *Legal Considerations in the Purchase and Sale of Oil and Gas Properties (Part One),* Oil and Gas Analyst, November 1983.

6. Davis, Gary W. and Christiansen, Mark D., *Legal Considerations in the Purchase and Sale of Oil and Gas Properties (Part Two),* December 1983. Comment: This work was also presented in an expanded form under the title *The Purchase and Sale Agreement* at the Oklahoma City University School of Law seminar on Buying and Selling Mineral Interests on November 6, 1987.

7. Godfrey, Cullen M., *Legal Aspects of the Purchase and Sale of Oil and Gas Properties, Monograph Series No. 17,* American Bar Association, Section of Natural Resources, Energy, and Environmental Law, et al., Chicago, IL, 1992.

8. McGinnis, Michael W. and Stansberry, Mark A., *The Acquisition Process and Due Diligence: Minimize Risk/Maximize Return!,* Executive Dynamics Press, Dallas, TX, 1991.

9. Nee, Louis N. III, *Acquisitions and Divestments: Do Not Overlook Deferred Like-Kind Exchanges,* The Landman, January/February 1990.

10. Nestor, Donald B., *Acquisitions and Dispositions of Oil and Gas Properties: Tax Considerations,* The Landman, July/August 1988.

11. *Due Diligence, Part One: Acquisitions From the In-House Landman's Perspective,* Oklahoma City Association of Petroleum Landmen, Oklahoma City, OK, 1992.

12. *Due Diligence, Part Two: Field Land Accounting, Conversions and Title Opinions,* Oklahoma City Association of Petroleum Landmen, Oklahoma City, OK, 1993.

13. Petrus Oil Company, L.P., Land Department, *Acquisition of Producing Property: Producer's Perspective,* The Landman, January/February, 1988.

14. Pettit, Robert Y., and Pettit, Edward Y., *The Competent Landman and Due Diligence,* The Landman, September/October, 1987.

15. Redic, John G., *Reserve Analysis & Economic Evaluation of Producing Oil & Gas Properties,* The Landman, May/June, 1988.

16. *Institute on Oil and Gas Agreements,* Rocky Mountain Mineral Law Foundation, Denver, CO, 1983.

17. *Problems and Opportunities During Hard Times in the Mineral Industry,* Rocky Mountain Mineral Law Foundation, Denver, CO, 1986.

18. Rooke, Eugene O., *Purchasing Producing Properties: Getting What You Purchased,* 33rd Rocky Mountain Mineral Law Institute 7-1, 1988.

19. Sinex, Donald G., and Jones, Sidney F., Jr., *Landman's Overview of Producing Property Acquisitions,* The Landman, January, 1985.

20. Tinkler, James C., *Joint Ventures and Financing of Acquisitions,* The Landman, May/June, 1990.

INSTRUCTIONS AND QUESTIONS

FOR CONTINUING EDUCATION OR RECERTIFICATION CREDITS

This home study course has been designed to provide the reader with an understanding of the due diligence process during the purchase and sale of oil and gas properties. Upon the satisfactory completion of the following questions as determined by the AAPL Director of Education and Research, the Registered Land Professional (RLP) or Certified Professional Landman (CPL), as the case may be, will be

1. awarded 10 RLP continuing education or CPL recertification credits, or

2. notified that he/she has not demonstrated an adequate understanding of the home study course materials.

If the RLP or CPL is notified of unsatisfactory completion of the following home study course questions, the AAPL Director of Education and Research will request that the RLP or CPL answer additional questions concerning the home study course materials.

In order to receive the 10 continuing education or recertification credits, the RLP or CPL will be required to **satisfactorily complete** the home study course questions within one year to the day AAPL ships the home study course to the participant. This date will be postmarked on the envelope in which the home study course materials will be shipped to the course participant. Continuing education or recertification credits will only be awarded to a RLP or CPL who has purchased this home study course from the AAPL according to AAPL records.

On a separate sheet(s), please list each of the following 22 questions with your corresponding answers. Answer the questions as thoroughly as possible. If possible, please use a computer or a typewriter for this assignment. However, if that is not possible, please write or print legibly. When you have completed the questions and answers to your satisfaction, please forward them with a short cover letter to the AAPL Director of Education and Research, c/o AAPL, 4100 Fossil Creek Boulevard, Fort Worth, TX 76137-2791. This home study course booklet is yours to keep.

Upon receipt of the materials you have forwarded, the AAPL Director of Education and Research will review them and make a determination whether or not you have demonstrated an adequate understanding of the home study course. You should be notified of his decision within two weeks of AAPL's receipt of your materials.

QUESTIONS:

1. List the seven basic steps common to most purchase and sale transactions.

2. Discuss what is involved in preparing for a property sale from the seller's point of view.

3. Discuss what is involved in preparing for a property acquisition from the buyer's point of view.

4. Identify and discuss the critical elements of a purchase and sale agreement.

5. a) Discuss what is meant by the term "due diligence."
   b) What is buyer's responsibility in the due diligence search?

6. Discuss what is involved in an "inside examination." Identify information which is critical to be reviewed to achieve proper due diligence.

7. Describe what is included in an "outside examination" while performing due diligence.

8. What other professional disciplines are usually involved in due diligence and, in general, what are their responsibilities?

9. Discuss what matters must be completed prior to closing to satisfy the requirements of most purchase and sale agreements.

10. Discuss what leads to a speedy and efficient closing.

11. Discuss what actions will be required subsequent to closing to facilitate efficient management of an acquired property.

12. Provide an overview discussion of how the land professional will relate to, interact with and/or be responsible for the various activities involved in a energy or mineral property disposition/acquisition.

13. List selection criteria to identify properties that should be sold.

14. Identify methods used by the seller to value properties.

15. What is the bid package and what are its typical components?

16. Discuss the purpose of the letter of intent and methods for its use.

17. Discuss the importance of critical dates and give examples.

18. Discuss and define the major value list, the 80/20 rule and why environmental consider-

ations are an exception to the 80/20 rule.

19. What is the purpose/function of the title report? What information should be included therein?

20. What types of files should you look for from seller and what types of information would you expect to find in each?

21. Discuss the smell test.

22. Discuss the Phase I environmental site assessment. Briefly discuss the Phase II and Phase III environmental site assessments.