Acquisitions, Due Diligence and Title

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South Texas College of Law, J.D., 1978
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Oil and Gas Energy Resources Law Section of the State Bar of Texas - Member
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Managing Partner of Sadler Law Firm LLP, 1980-Present
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I. INTRODUCTION

The purpose of this paper is to discuss the title examination process as it relates to the due diligence aspects of an acquisition of producing oil and gas properties by a buying company ("Buyer") from a selling company ("Seller") through the mechanism of a traditional purchase and sale agreement or one commonly used in the oil and gas industry. Due diligence, in the broadest use of the term, is an integral part of the acquisition transaction, from the offering of the properties for sale through the closing of the transaction. It provides the Buyer, and often as importantly- the lender/investor, with verification that the oil and gas properties are as represented in the purchase and sale agreement. The due diligence process involves all of the different professional disciplines within an exploration and production company. This paper will focus on very practical legal services that an attorney may be required to perform once he or she receives the telephone call from an excited client who is the successful bidder on an oil and gas property.

II. UNDERSTANDING THE TRANSACTION

Based on my experience, an attorney cannot be too familiar with the various aspects of the acquisition process. Each transaction is different and a familiarity with the unique aspects of the elements of the transaction prepare the attorney to better identify what title due diligence encompasses in a specific transaction. Facts are the foundation of any legal matter and it is imperative for any attorney involved in an acquisition to understand as many facts about the transaction as possible.

A. Seller

Who is the Seller and what do you know about the Seller? The selling party may be a major international oil and gas corporation who is seeking to dispose of assets it considers less profitable than its management desires, or a small limited liability company or partnership backed by a private equity investor who seeks to sell its assets to either reduce a loss, maximize a gain, or to acquire cash for another opportunity. In between these two types of Sellers are a variety of enterprises that have different goals in the disposition of the properties each seeks to sell. Relevant in today's market is the financial situation of the Seller and whether the Seller may be suffering economically due to market conditions or legal complications?

B. Buyer

The Buyer will likely be your client. A knowledge and understanding of your client's goals related to the transaction will affect the due diligence process and your obligations and responsibilities during the due diligence process. Some factors to consider are whether the Buyer is purchasing the properties for cash or through existing credit agreements, the Buyer's experience in the acquisition of oil and gas properties, and whether or not the Buyer seeking to acquire the oil and gas properties for long term investment and development, or to drill a few wells and sell the properties after 3-5 years. In addition, the attorney should obtain a clear understanding of the risk tolerance of its client and its financiers, and a thorough understanding of your client's goals. ASK ENOUGH QUESTIONS. The attorney cannot ask too many questions relative to the transaction, the client's goals, the client's level of risk tolerance, and the time constraints placed on the transaction by the purchase and sale agreement.

C. Properties of the Transaction

Over the last few years with the expansion of the unconventional development of oil and gas properties, the transaction could be for the purchase of oil and gas properties located in any number of different states with different laws and regulatory rules and procedures. Legal considerations are vital to an effective representation and analysis. For example, a 10,000 acres lease in Midland County, Texas, will result in a different legal analysis, then a 10,000 acres lease in Washington County, Pennsylvania. Other transaction considerations include factors such as the number of wells in the asset package, the nature of the wells- such as whether they are vertical or horizontal, and whether they are Proved Developed Producing (PDP), Proved Behind Pipe (PBP), or Proved Undeveloped (PUD) and the actual quantum of wells.

In addition to the well count, the location of the properties might be important, such as whether they are located in a concentrated area or are scattered throughout different counties and fields in the state. The due diligence process will be affected by the number of the oil and gas leases involved, voluntary pooling and forced pooled units, including secondary recovery units.

The age of the properties is another factor which should be a consideration; for example, are the oil and gas assets located on oil and gas leases within their primary term, or are the oil and gas leases in their secondary term, considered held by production (HBP). The oil and gas leases may likely be beyond the primary term, but could be subject to a continuous drilling obligation requiring the drilling of additional wells at specific periods of time in order to maintain the entire lease prior to a partial termination. Certainly, such facts

will add to future anticipated costs for maintaining a leasehold and anticipated revenue generated by the oil and gas properties. Regardless of the age of the properties, the various properties may be subject to any number of horizontal severances with different working interest ownership at different subsurface intervals. The attorney should also be aware whether the oil and gas leases contain any unusual terms or conditions which could have a dramatic impact on their actual or anticipated value to the Buyer. The same consideration should be given to the ancillary agreements which facilitate the future operation of the properties without interruption.

III. OVERVIEW OF PURCHASE AND SALE PROCESS

The due diligence process normally begins after initial terms of the sale have been agreed to by the parties. Just like the Seller and Buyer of a house negotiate a deal before obtaining a title report, the Seller and Buyer of oil and gas interests usually "make their deal" before bringing in the due diligence team. Eventually, the terms of the sale are set forth in detail in the form of a purchase and sale agreement, which generally occurs prior to the commencement of most due diligence activities.

People have been horse trading since, well-since God created Men and Horses. Practically every major University offers an entire curriculum on the motivations of why people buy and why people sell (anything). Likewise, the hows and whys of oil and gas asset trades continues to be the subject of a large number of excellent papers which discuss in detail the preparation of properties for sale, the process of offering the properties for sale, confidentiality agreements related to reviewing oil and gas properties, and the various types of offerings to purchase oil and gas properties.

The bibliography of this paper references a number of fine papers, which this author recommends, for an in depth discussion of the types of agreements that are required during the process of the acquisition of producing properties. However, the mention of some of such agreements and their terms and provisions are relevant to the discussion of the due diligence process.

A. Letter of Intent

Once a Seller and Buyer have agreed on the general terms to the sale of oil and gas properties, their agreement is memorialized in a letter of intent ("LOI"). An LOI is like a handshake agreement that everyone agrees to make a best effort to consummate the transaction. The LOI identifies the parties, a general description of the sale assets, the purchase price, general guidelines on how due diligence is to be conducted, an agreement that the LOI is conditioned on and subject to the execution of a definitive purchase and sale agreement. The LOI may contain several other conditions which must be met before either party is required to conclude the transaction. The planning and organizing of the due diligence process begins in full earnest following the execution of the LOI.

B. Purchase and Sale Agreement

The purchase and sale agreement outlines, in very specific terms, the essential rights and obligations of the Seller and the Buyer in the transaction. This agreement contains elements such as purchase price, purchase price adjustments, representations and warranties of the parties, various covenants regarding the operations of the properties, allowed expenditures of the Seller on the properties pending closing, the nature of the title of the properties being sold, and obligations of all parties after closing.

Importantly for the purposes of title due diligence, the purchase and sale agreement specifies various dates regarding when certain actions and obligations should be performed, from execution to closing. In addition, a purchase and sale agreement will contain detailed terms and provisions as to what constitutes a title defect, parameters of when notice of title defects must be delivered to Seller, the economic effects of the failure to deliver notices of title defects, how title defects are remedied, how the parties will value the title defects, and the economic value of title defects relative to adjustments on the purchase price.

1. Marketable Title

Obviously, Buyers invest in an asset with the expectation to make a reasonable return on their investment. If the investment is in oil and gas properties, the Buyer must confirm to its satisfaction that the Seller actually owns the interests the Seller is purporting to sell, and the Buyer is actually receiving titled ownership to the properties, free of any unanticipated significant economic diminution in value, free and clear of liens and without serious legal claims. The marketability of title to an interest in and to oil, gas and other minerals, is generally speaking from the Buyer's perspective, one which is free from reasonable doubt and will not expose the party who holds it to the hazards of litigation. Marketable Title is defined in Standard 2.10 of the Texas Title Examination Standards as

> ". . . a *record* title that is free from reasonable doubt such that a prudent person, with knowledge of all salient facts and circumstances and their legal significance, would be willing to accept it. To be marketable, a title need not be

absolutely free from every possible suspicion. The mere possibility of a defect that has no probable basis does not show an unmarketable title."

The Comment to Standard 2.10 provides, subject to certain exceptions, that if a title examination reveals the need to rely on facts outside of the record, the title is unmarketable. This Comment lists seven matters that may make a title unmarketable, including, (1) land acquired by limitation title, (2) land acquired by accretion, (3) title that is subject to an outstanding oil and gas lease, (4) title that is subject to an outstanding royalty interest, (5) title that is subject to an outstanding covenant, (6) title that is subject to an outstanding easement, and (7) title that is subject to a mortgage, judgment lien or tax lien.

2. Purchase and Sale Agreement Title

Most purchase and sale agreements will define three terms that are definitive of whether a "Title Defect" (defined by example below) exists with respect to the interest of Seller in and to the oil and gas properties subject to the purchase and sale agreement. The terms which define the standard of title to be met are (1) Defensible Title or similar term, (2) Permitted Encumbrances, and (3) Title Defect. The interpretation and interrelation of Defensible Title, Permitted Encumbrances and Title Defect are clearly not Marketable Title as defined by the Texas Title Examination Standards. Examples of these defined terms are as follows:

a. "Defensible Title" means such right, title or interest held by Seller that (i) will entitle Buyer, as Seller's successor, to receive not less than the net revenue interests described in Exhibit A of all oil, gas, condensate, related hydrocarbons and other minerals produced under the terms of the Leases (or other property denominated in Exhibit A); (ii) will obligate Buyer, as Seller's successor, to bear a percentage of costs and expenses related to the maintenance, operation and development of the Leases (or other property denominated in Exhibit A) not greater than the working interest shown in Exhibit A, unless the circumstances causing the working interest to be greater will cause the corresponding net revenue interest to increase in the same proportion; and (iii) is free of all liens, security interests, encumbrances and defects, except for Permitted Encumbrances.

b. "Permitted Encumbrances" are:
(a) lessor's royalties, overriding royalties, production payments, net profits interests, reversionary interests and similar burdens on production that does not, and will not, reduce Buyer's net revenue interest, as Seller's successor in title, below the net revenue interest shown in Exhibit A or increase Buyer's working interest, as Seller's successor in title, above the working interest shown in Exhibit A (unless the circumstance causing the working interest to increase will cause the corresponding net revenue interest to increase in the same proportion);
(b) preferential rights to purchase and third party consents with respect to which, prior to Closing, (i) waivers or consents are obtained from the appropriate parties or (ii) the time for asserting such rights has expired without exercise;
(c) mechanics', materialmen's, operators', tax and similar liens or charges arising in the ordinary course of business related to an interest if such liens secure payments not yet due;
(d) all consents from, notices to, approvals by or other actions by governmental authority in connection with sale or transfer of properties as to the Interests if such matters are customarily and appropriately obtained after the sale or transfer;
(e) liens, security interests or other encumbrances to be released at or prior to Closing;
(f) rights of a governmental entity to control or regulate the Interests, together with all applicable laws, rules and regulations;
(g) easements, rights-of-way, surface leases and other surface use restrictions if such restrictions will not materially adversely affect the use, value or operation of the Interests; and
(h) title matters waived or deemed to be waived by Buyer hereunder.

c. "Title Defect" means any encumbrance, irregularity or defect in Seller's title to an Interest which, alone or in combination with other defects, causes Seller's title to be less than Defensible Title.

Understanding the definition of these or similar terms as agreed to by the parties in a purchase and sale agreement is imperative for the attorney in relation to conducting due diligence for the Buyer on the subject oil and gas properties. In addition, depending on whether it is a "Buyer's Market" or a "Seller's Market", the elements of the definitions of Defensible Title, Permitted Encumbrances, and Title Defect will be modified to benefit the party having the stronger bargaining position.

One of the most important provisions related to Title Defects is the notice of title defects provisions which normally provide that the Buyer's failure to give notice of a Title Defect within the time and manner specified in purchase and sale agreement shall be a waiver by Buyer of the Title Defect and the Title Defect shall be treated as a Permitted Encumbrance. The legal axiom "Time is of the Essence" never had greater meaning than as related to timely giving notice to the Seller of Title Defects.

Under the terms of the purchase and sale agreement, a Title Defect is given a monetary value, which if not cured, will cause a reduction in the purchase price. The value of Title Defects that are not cured could cause a substantial reduction of the purchase price, or in the extreme, a condition to not close the transaction. The attorney should strive to identify all anticipated or determinable Title Defects relating to the oil and gas properties, which will impact the economic considerations of the transaction for the Buyer.

C. Conditions to Closing

Let it suffice for the purpose of this paper that the ultimate goal of the Seller and Buyer is that the transaction will close as agreed to by both parties in the purchase and sale agreement, and with both parties leaving the closing room confident that each reached all of their anticipated economic goals. Some of the papers referenced in the bibliography contain examples of closing checklists which offers in a general way the complexity of the closing portion of the transaction.

All purchase and sale agreements will contain conditions, which if not met, will relieve one party or the other of the obligation to close the transaction. In many instances, the Buyer's condition to close may be information or changes in the representations of the sale assets that will be discovered by the attorney during the title due diligence phase of the transaction.

D. Time Restrictions

Generally speaking, the time between the execution of the purchase and sale agreement and closing is between 30 to 45 days. In a perfect world this time period would be more than an adequate time for the Buyer to satisfy itself that the Seller's represented interests in the oil and gas assets, which it seeks to purchase, are as represented and free and clear of liens and encumbrances, but this is not a perfect world. The number of unanticipated delays due to the collection, availability and review of information in the due diligence process and its assimilation into a title defect or a title opinion are limitless. Since the deadline for submitting title defects is not negotiable once the purchase and sale agreement is executed, the coordination of the efforts of the Buyer, the attorney and all other professionals involved is essential to a positive outcome for the client.

IV. CREDIT AGREEMENTS AND FACILITIES

If a Buyer utilizes an existing credit facility or enters into one to finance the purchase of the sale assets, the credit agreement will contain covenants, and more probably, representations and warranties regarding the title of the Buyer (as Borrower) to the oil and gas properties pledged or to be pledged as collateral under the terms of the credit agreement. The representations and warranties of title in the credit agreement should be reviewed in relation to the standard of title to be delivered under the terms of the purchase and sale agreement. The standard of title delivered to Buyer under the purchase and sale agreement should align with the representations and warranties given by the Buyer (as Borrower) under the credit agreement. A general statement of warranty to the oil and gas properties in a credit agreement could be that Buyer (as Borrower) "has good and indefeasible title to all of the oil and gas properties, free and clear of all liens except permitted liens, and that no person other than the Borrower has any ownership interest, whether legal or beneficial, in any oil and gas property of the Borrower, except to the extent of permitted liens." Of course, terms such as oil and gas property, liens, and permitted liens would be specifically defined terms in the credit agreement and are of utmost importance to understand. There exists the possibility of a conflict in the title delivered or to be delivered to Buyer under the terms of the purchase and sale agreement and the title to the oil and gas assets as collateral which Buyer (as Borrower) is representing to the lender under the credit agreement.

V. ASPECTS OF DUE DILIGENCE UNRELATED TO TITLE

Unrelated to title due diligence, the due diligence process will include due diligence of the Seller's records, files and data related to its engineering operations, legal obligations, accounting (both revenue and costs related to the oil and gas asset), environmental, and marketing relating to the sale by Seller of its oil and gas products. All of the different aspects of due diligence, including title due diligence, will be occurring simultaneously and require a high degree of coordination, cooperation and communication between all parties participating in the due diligence process. The level of due diligence depends on the short-term or long-term strategy of the Buyer with respect to the oil and gas properties.

VI. TITLE DUE DILIGENCE

A. Coordination of Due Diligence and Planning

Each Buyer will plan and coordinate its due diligence efforts in order to meet its goals with respect to the purchase of the oil and gas assets. As has been

previously mentioned and stressed above, planning, coordination, cooperation and communication with the client is essential at all times during the due diligence process. Generally the Buyer will organize its due diligence activities by teams of professionals who will be given responsibility for conducting different aspects of the due diligence process. Most Buyers will divide the due diligence process into three parts, record title review, environmental due diligence and the in-house review, which will include accounting, engineering, and land and contract due diligence reviews.

In deciding which oil and gas properties should be subjected to the due diligence process, many of today's Buyers use an economic evaluation of the oil and gas properties commonly referred to as the 20/80 rule, which means that 20% of the oil and gas properties to be purchased in the aggregate constitute 80% of the value of the properties being acquired. This valuation is based on reserve reports and other information obtained by the Buyer or provided by the Seller and confirmed by the Buyer to its satisfaction. Based on the 20/80 rule the Buyer will identify those properties which fall within this designation and concentrate its due diligence efforts on those properties. The identified properties will generally be the only properties on which the Buyer will concentrate its due diligence efforts to verify the title representations of the Seller. Again, depending on the size of the transaction in terms of monetary value and volume of properties, the period of due diligence can become extremely compressed for the attorney and other members of the due diligence teams.

B. Allocation of Responsibility

1. Seller's Records

The current trend in title due diligence of the Seller's property records is delegated to a team of landmen who will review the lease files, the division order files, the contract files and other miscellaneous records of the Seller, as each set of files relate to the oil and gas assets being sold. Based on the definition of Defensible Title, Permitted Encumbrances and Title Defect and the size of the transaction, the level of review and the records reviewed may change dramatically from one transaction to another.

2. Public Records

As has become the generally accepted practice, landmen will be provided copies of the most recent title opinion covering the Seller's interest in the oil and gas property, and landmen will be dispatched to the various counties where the properties are located to review the official records of real property related to the interest of the Seller. A runsheet or index of the documents filed of record since the closing date of the prior opinion and recorded copies of such instruments will be provided to the attorney for examination and the rendering of a title opinion. The title opinion should be prepared and delivered to the Buyer in sufficient time for the Buyer to review, analyze and assess all title defects and then to deliver timely title defect notices to the Seller.

VII. DIFFERENCES IN RECORD TITLE EXAMINATION AND TITLE DUE DILIGENCE

A. Purchase and Sale Agreement definitions determine what constitutes a Title Defect

The attorney should be provided with a copy of the Title Defects section of the purchase and sale agreement and any title covenants or representations in existing credit facilities or credit facilities being negotiated in conjunction with the purchase of the oil and gas properties. Depending on the client and the individual attorney's involvement with the entire due diligence process, the examining attorney may be provided with the valuation schedule of the oil and gas assets in the sales package, which sets forth the represented Gross Working Interest and the Net Revenue Interest of the Seller, as such schedule of values is set forth in the purchase and sale agreement. The definition of Defensible Title and Title Defect both involve some increase or decrease in the represented Gross Working Interest and Net Revenue Interest of the Seller in the oil and gas properties scheduled as part of the purchase and sale agreement. The determination and identification of an increase or decrease in the Gross Working Interest and Net Revenue Interest of the Seller in the oil and gas properties, and the satisfaction of the conditions to closing, which results in part from information generated outside of the record title, is the major difference in title due diligence and in title opinions generated only based on record title. As a matter of course, the existence of liens and encumbrances affecting Seller's interests will be identified in both title due diligence and title opinions based on record title.

B. Title Examination based on Record Title

The type of title examination to be conducted and the type and substance of the title opinion should be coordinated with the client. The title examination should be limited to the interest of Seller, and identify any liens, encumbrances or the other matters that the attorney would normally address in a title opinion for other oil and gas purposes regardless of the limitations on the definition of Title Defect set out in the purchase and sale agreement. The client may request other limitations on the title examination, such as limiting the attorney's access to unrecorded agreements, or by identifying the specific depths or lands to be covered by the title opinion.

VIII. SPECIFICS OF TITLE DUE DILIGENCE PROCESS

A. Risk Tolerance of the Client

The attorney's understanding of the risk tolerance of the client cannot be understated. The risk tolerance of the client will vary from transaction to transaction based on the size of the transaction and the short-term or long-term strategy of the client. A transaction in which the client is risking a few million dollars verses a transaction in which the client is risking several hundred million dollars will definitely affect the degree to which any given title defect has on the particular transaction.

B. Deadlines in Process

As discussed above, once the purchase and sale agreement is executed, the period of time in which the title due diligence may be completed in order for the Buyer to timely deliver title defect notices or confirm to its satisfaction that all of its conditions to closing are met, are not negotiable. The attorney should know the dates which are required for completion of his legal services under the terms of the purchase and sale agreement of any transaction and use best efforts to meet the prescribe deadlines.

C. In-house Due Diligence

The landman team examining the Seller's records will be reviewing the lease files, division order files, contract files, and the revenue and joint interest billing ("JIB") decks. Depending on the available time, the complexity of the transaction, and the title due diligence process, the attorney may be requested to participate as a part of the in-house Due Diligence team.

1. Lease Files – These files are reviewed to determine if the leases on which the wells are located are still in force and effect. Other critical issues are discussed and listed below.
   a. The files will be reviewed for payment of delay rentals, shut-in royalties, lease amendments, ratifications, or any other information in the file that may reveal a defect or discrepancy with the oil and gas lease or affect an increase in the royalty provided in the oil and gas lease.
   b. If the oil and gas lease has been voluntarily pooled, a determination should be made if the oil and gas lease was properly pooled with other leases according to the terms and provisions of the leases.
   c. A determination should be made whether the oil and gas lease contains a retained acreage provision or horizontal severance provision that may have terminated the lease as to acreage or depths originally covered by the lease.
   d. A determination should be made whether the oil and gas lease contains any special surface damage or restriction provisions that may impair the long term benefit and operation of specific property.
   e. A determination should be made whether the files reveal any specific lessor complaints.
   f. The files reviewed should verify that all of the oil and gas leases are on the proper schedule and properly described on the schedules to the purchase and sale agreement.
   g. A review of the division order files should be conducted to determine that the division orders reflect the represented Gross Working Interest and Net Revenue Interest of the Seller in the oil and gas assets.
   h. The suspense files should be reviewed to determine if any interest is in suspense, the amount of the suspense funds and the reason for the interest to be in suspense.
   i. The files should be reviewed for any threatened lawsuits, disputes, demand letters or other information which would put the validity of the oil and gas lease in question.
   j. Lease files should be reviewed for the required notifications, waivers, consents and third party approvals affecting the oil and gas leases and interests therein.
   k. Lease files should be reviewed for depth limitations or "pugh type" clauses in the oil and gas leases that are not disclosed on the schedules to the purchase and sale agreement.

2. Contract Files
   a. Joint Operating Agreements should be reviewed to determine any of the following provisions:
   (1) the form of the agreement;
   (2) any conflicts between multiple-joint operating agreements on the same property or related unitization agreements;
   (3) change of operator provisions;
   (4) any area of mutual interest ("AMI") provisions;
   (5) gas balancing agreements (over-produced; under-produced);
   (6) calls on production;
   (7) uniform maintenance of interest provisions;
   (8) preferential rights to purchase; and
   (9) area of mutual interests provisions.
   b. Participation Agreements, Farmout Agreements, Unitization Agreements, and Assignments should be reviewed for any of the following issues in addition to the ones stated above:
   (1) reversionary interests,
   (2) before and after payout status,
   (3) drilling obligations, and
   (4) rights of re-assignment.

   The schedules to the purchase and sale agreement should be reviewed to verify that all of the above referenced agreements have been properly included and described on the appropriate schedules.
   c. Contract Files should be reviewed for reversionary interests yet to be exercised or that have not yet occurred or reassignment obligations which will cause a reduction in the represented Gross Working Interest and the Net Revenue Interest of the Seller.
   d. Revenue and JIB decks should be reviewed to confirm that the represented Gross Working Interests and Net Revenue Interests on the schedules to the purchase and sale agreement are the same interests as reflected on the records of the Seller.
   e. Contract Files should be reviewed for required notifications, waivers, consents and third party approvals within the above mentioned agreements.
   f. Contract Files should be reviewed for depth limitations within the above referenced agreements that are not disclosed on the schedules to the purchase and sale agreement.

D. Title Examination

The following listed items and issues should be identified and set forth in the title opinion rendered as a result of the title examination of the oil and gas properties which are the subject to the purchase and sale agreement ("Limited Title Opinion"). The list is by no means exhaustive but only identifies some of the title issues commonly encountered in the title examination process. The list will include some issues identified in the title due diligence process outside of the record, where such documents are provided for examination. The following discussion includes some comments and suggestions as to the type of information and form of the title opinion to be rendered.

The Limited Title Opinion may encompass all or any of the following constituent parts.

1. Be addressed to your client; however, there may be circumstances in which the title opinion may need to be addressed to the lender of the credit agreement of the Buyer in order to satisfy various covenants in the credit agreement. In such a case, counsel for the lender should be consulted as to any particular formatting and content requirements as set forth in the credit agreement.
2. A division of interest similar to that found in the traditional oil and gas title opinion format, or the division of interest may be modified to opine as to the record title Gross Working Interests and Net Revenue Interests of Seller, and an additional section that sets forth

represented the Gross Working Interest and Net Revenue Interests of Seller as set forth on the schedules to the purchase and sale agreement and containing language which duplicates the language of the purchase and sale agreement as to the manner in which the Gross Working Interest and Net Revenue Interest are defined therein, and identify any differences that are reflected by record title.

3. A list of all prior title opinions provided in conjunction with the title examination and reviewed as a part of the instruments examined and upon which the Limited Title Opinion is based.
4. A discussion of the requirements of the prior title opinions as to whether such requirements are satisfied, unsatisfied, previously waived by a successor in interest or waived by the Seller, advisory only, or are inapplicable to the title of the Seller, and include prior noted defects which could change the represented Gross Working Interest and Net Revenue Interest of Seller.
5. Set forth limitations and disclaimers with respect to any excluded and unrecorded instruments not provided for examination, the location of wells, either surface or bottomhole, and whether such wells located on the oil and gas leases are at a legal location under the rules of the Railroad Commission of Texas, and the depths from which the wells are producing.
6. A discussion of the oil and gas lease or leases as to whether each is within its primary term or secondary term, and maintained by production as provided by the terms of the leases, and whether the attorney was provided with information to evidence the production history of the wells.
7. Set forth the status of ad valorem taxes assessed against the surface and mineral estates, whether paid or delinquent.
8. Set forth a list of all pending litigation disclosed of record;
9. A list of all surface use agreements and easements of record, and if relevant, any terms and provisions thereof related to duration of the agreement, restrictions contained therein or provisions which could cause a termination of the agreement or easement, or create a limitation on the use of the property by the Buyer.
10. A legal description of the lands covered by the oil and gas lease or leases on which the opinion is based.
11. The identification of all wells located on the oil and gas leases or units, as the case may be, to the extent disclosed of record or by documents outside the record which were provided as a part of the examination.
12. A detailed list of all liens, encumbrances, UCC financing statements, lis pendens, abstracts of judgments, pooling or unitization agreements affecting the lands which are the subject of the examination, regardless of whether same are to be released at closing.
13. A description of all instruments, documents and prior title opinions which are outside of the record provided for a basis of the examination.

Additional title issues which are commonly encountered that should be included and discussed in the Limited Title Opinion are as follows:

a. merger documents not of record;
b. all necessary ratifications of the oil and gas leases or units;
c. the proper pooling of oil and gas leases as required by the terms and provisions of the leases;
d. conveyances and assignments by strangers in title;
e. with regard to the State of Texas leases, have the conveyance instruments and other documents required by statute been filed in the lease file in the General Land Office;
f. preferential rights of purchase or calls on production contained within assignments of record;
g. any consents to assign contained in the oil and gas leases or other restrictions on transfer of the lease rights; and
h. Gaps in the mineral or leasehold title.

E. Title Defect Notices and Remedies

Depending on the experience of the client in purchasing producing oil and gas properties and the relationship between the attorney and the client throughout the entire purchase and sale process, the attorney may be asked to prepare title defect notices.

Typically the purchase and sale agreement will contain provisions as to the content and information that is to be included in a notice of title defect, such as (a) a description of the oil and gas property affected by the title defect; (b) an adequate explanation of the basis for the title defect; and (c) the amount by which the Buyer believes the value of the affected oil and gas property has been reduced by the title defect.

The purchase and sale agreement will set forth the terms for remedies of the title defects. The Seller is normally given an opportunity to cure the title defect or the election not to cure the title defect. If a title defect is not cured, normally the purchase price will be reduced based on some valuation standard set forth in the purchase and sale agreement.

The value of a title defect may have a threshold dollar amount of the claimed title defect which must be met in order for title defect to be claimed under the agreement. The methods of remedy of a claimed title defect are varied based on the bargaining positions of the Seller and Buyer. The value of a claimed title defect may be based on the costs to cure or the reduction in value to an individual property based on the amount of the decrease in the Gross Working Interest and the accompanying decrease in the Net Revenue Interest. The monetary value of the decrease in the purchase price would be based on the decrease in the amount of the Gross Working Interest and accompanying decrease in the Net Revenue Interest multiplied by the monetary value given to the oil and gas property on the value (dollar amount) allocation schedule for each property that is attached to the purchase and sale agreement. The purchase and sale agreement may provide that once an aggregate dollar amount of title defects is reached, then either party may terminate the purchase and sale agreement. Generally the remedy provisions will require the parties to meet and negotiate in good faith to reach an agreement as to the value of any title defect before any termination provisions would be utilized. Often times, the parties will have a disagreement as to a title defect, perhaps one that is still contingent or cannot be cured before closing but the Buyer elects to purchase the oil and gas property subject to the parties entering into a title indemnity agreement. The above discussion is just an example of the types of remedies available, but each transaction is unique and will likely have a unique set of methods for curing title defects and the manner of their remedy.

IX. CONCLUSION

Despite the harried pace at which the title due process takes place, the seemingly endless number of surprises found in some old dusty file, the process can be well managed. The title due diligence process requires a very coordinated effort organized and managed through a team effort that requires cooperation, coordination and communication. While every transaction is different in magnitude and complexity, certain patterns and processes can be applied to each transaction, and adapted to the particular transaction, such that at the end of the day the Seller and Buyer are generally satisfied that each received the benefits it contemplated by entering into the transaction in the first place. For the attorney and the rest of the due diligence team, it's time for a vacation; although that seldom happens.

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