ORGANIZING AND EXECUTING EFFECTIVE DUE DILIGENCE... QUICKLY!

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He is a past President of the Houston Association of Professional Landmen and has served in various positions with the American Association of Professional Landmen including Education Committee Chair and has served on the Association’s Board of Directors as a member of the Executive Committee. Randy has been recognized for his service to the industry by HAPL as Landman of the Year in 2008. He was selected for inclusion in Houston Business Journal’s list of Who’s Who in Energy, 2012 and as one of TIPRO and Texas Monthly’s Texas Top 15 Landmen in Texas, 2013.

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ORGANIZING AND EXECUTING EFFECTIVE DUE DILIGENCE... QUICKLY!

I. INTRODUCTION

A well organized and executed due diligence review is a key component to a successful acquisition of oil and gas properties, particularly producing oil and gas properties. It will determine whether there are any factors, such as loss of title, litigation, environmental problems, obligations and liabilities which would have a material adverse impact on the assets that a Buyer, investor or lender should know about. It also serves to verify the basic business, economic and operational assumptions a Buyer has made to determine the value the assets will have to the Buyer and the purchase price a Buyer is willing to pay for those assets.

The basic structure of the due diligence review will be determined by the nature of the transaction, the provisions of the Purchase Agreement, if there is one, and the issues that arise as the due diligence process progresses. Due diligence is an organic process and its course and scope can change as more information about the properties under review becomes available. These factors will play a role in how smoothly the process will go, how long it will take, and how much it will cost.

An effective due diligence review cannot be accomplished by simply pulling out copies of old due diligence checklists and forms and distributing them to the due diligence team. Although that may be a good place to start, an effective due diligence review will include custom made, continually changing checklists designed specifically for the transaction. They will address the relevant issues unique to that transaction. A successful due diligence review must also include the right people, the right goals and objectives, and the right processes to achieve those goals and objectives. These elements require a sophisticated knowledge of the principles and fundamentals of due diligence.

Conducting the due diligence review is usually a daunting task and there must be a well thought out plan in order to assemble, report and evaluate all of the issues that are significant for a successful transaction. This article will outline and discuss the general parameters of a due diligence review in the context of the acquisition of upstream oil and gas properties from the Buyer’s perspective. It also covers the general elements of an acquisition due diligence review and will cover among other things, how the nature of the transaction and the contract language affects the review, what has to be reviewed, handling defects, due diligence team responsibilities, and scheduling and otherwise dealing with short time frames.

There is never enough time or enough people to accomplish a “perfect” due diligence review. Success is measured by how well the due diligence plan and the teams adapt to changing
requirements and how well resources are allocated to accomplish as many of the goals and objectives as possible, within the time allotted.

II. THE BASIC PARAMETERS OF THE DUE DILIGENCE REVIEW

Before we can begin designing and planning the due diligence review, we need to know some basic information about the transaction. The following information will constitute the basic parameters of the transaction and will constitute a good first list of questions to ask. This information should be continually developed throughout the review process.

A. Name of the Seller
B. The nature of the transaction (asset or stock transaction)
C. List of properties and their allocated values
D. Seller’s relationship to the properties (e.g. Operator, Non-Operator, Owner, Agent)
E. The nature of the specific properties (what kind of properties are they and where are they located?)
F. Buyer’s relationship to the properties. (will Buyer take over operations, own a working interest or a royalty interest or a fee interest?)
G. Anticipated Closing date
H. Deadline when title and environmental defects must be asserted
I. Other critical dates in the Purchase Agreement
J. Contact list of seller’s key personnel in each area of review.

III. PRINCIPLES THAT WILL MAKE THE PROCESS MORE EFFECTIVE AND EFFICIENT

The following are principles that when applied will make the due diligence review process more effective and efficient.

A. There should be a clear allocation of responsibilities among the participants. This allocation should be in writing. This written allocation of responsibilities will help reduce duplicative efforts.
B. Review procedures and responsibilities regularly and modify as appropriate. The due diligence process is not static and success will go to those who are able to adapt to changing circumstances most efficiently.

C. Establish written procedures for sharing information. It will not happen automatically.

D. Gather information on the results of due diligence in a uniform format, which is easy to read and understand.

E. Team leaders must work closely together at all stages. Relevant issues must be shared. Oftentimes issues material to one team are discovered by the inquiries by the other teams.

F. Communicate significant issues immediately as they may have an impact on the negotiations and may cause the transaction to be restructured, or terminated.

G. Follow good due diligence etiquette with seller’s personnel. You will gain more information and quicker access to information if you are friendly and cooperative. Due diligence personnel are charged to gather information and should not usually be adversarial.

IV. HOW THE NATURE OF THE TRANSACTION AFFECTS THE DUE DILIGENCE REVIEW

The nature of the transaction, the nature of the properties, the nature of Buyer’s relationship to the Seller and the nature of Buyer’s relationship to the properties has a direct effect on the due diligence review.

A. Asset transaction versus stock transaction

Generally, an asset purchase will provide for adjustments to the purchase price for individual title defects where a stock purchase will only provide for adjustments for matters that have a “material adverse effect” on the total value of the assets or the company. Also, liabilities in an asset acquisition can be allocated in varying ways between the Buyer and the Seller, while generally all liabilities are assumed by the Buyer in a stock transaction. Although the general nature of the review is very similar, the scope, depth and limitations of the due diligence review can be quite different.
B. Nature of the Properties

Each type of property, by its nature and complexity, carries with it a different level of title, operational, and environmental risk. Properties consisting of wells producing on a lease basis are much easier to review than large multi-tract units. Properties that have been 100% owned and operated by the Seller for many decades carry significantly less risk of title failure than properties that have been frequently sold. If the transaction is made up of numerous low value wells, then the due diligence review will be different from a transaction where there are a few high value wells. Distribution of value over the properties included in the transaction often has a significant impact of designing the due diligence program.

C. Nature of Buyer’s relationship to the Seller

Part of the scope of review is determined by the relationship between Buyer and Seller. Is the Seller an affiliate of the Buyer? Do the Seller and Buyer have an existing business relationship, i.e. are they co-owners or joint-venturers in other assets or in the same properties? What is the level of trust between them? This is important in determining how much you will be willing to rely on the representations and warranties in the Purchase Agreement.

D. Nature of Buyer’s relationship to the properties

The Buyer may be able to circumvent much of the due diligence review if he is familiar with the properties being purchased. For example, if the Buyer already owns an undivided leasehold working interest in the properties and is currently the operator of the properties, he will already be familiar with the base title, operational, marketing and environmental issues.

V. HOW DOES THE CONTRACT LANGUAGE AFFECT DUE DILIGENCE

The Purchase Agreement contains certain provisions that will set forth, among other things, (i) a description of the properties being sold, (ii) how much they will be sold for, (iii) the covenants that must be performed before Closing, (iv) the conditions to Close, (v) the representations and warranties that must be true in order to Close, (vi) how Defects will be addressed, and (vii) the obligations and liabilities that will be assumed by the Buyer. These are the provisions in the Purchase Agreement that are most relevant to the due diligence review and the contents of these provisions should be incorporated into the review.
The following is an outline of the provisions most commonly found in Purchase Agreements that are most relevant to the due diligence review and how they should be addressed in the due diligence review.

A. General Terms and Conditions:

1. Description of Assets (and Allocated Values); leases, wells, excluded assets

   While the description of properties and their respective allocated values in the Purchase Agreement constitute the definitive list of assets to be acquired, the current reserve report can also be used, because the reserve report usually contains the reserve and economic data relied upon by Buyer in negotiating the Purchase Agreement.

   **Practice Note:** It is important to verify that the working and net revenue interests used in the reserve report are the same as those used in the Purchase Agreement. Sometimes the working and net revenue interests used by the engineers are not the same as those shown in the land records.

2. Consideration

   Economies of scale should be applied to the due diligence review based on the allocated value of the assets being acquired. It is common to limit due diligence review to those properties that together comprise 80% of the value of the transaction. However, when there are numerous low value properties or a few very high value properties, this percentage may have to be adjusted.

3. Confidentiality

   All outsourcing services and contract personnel must be made aware that they are subject to the same confidentiality terms as Buyer. In certain circumstances the Seller will request or require that all such parties execute a confidentiality agreement prior to being given access to information.

4. Adjustments to Base Purchase Price; revenues, expenses, gas imbalances, taxes and defects.

   These matters should be worked in detail, because they represent real dollars. The review of those matters where monetary adjustments are provided for should take precedence over those that can be addressed based simply on materiality.
B. Covenants Pending Closing

Whether covenants and obligations of Buyer and Seller have been performed are usually conditions to closing. Confirming that each covenant and obligation has been performed is an objective of the due diligence review. The following are typical covenants that should be a focus in the due diligence review.

1. Seller’s
   a. Seller to allow access and time for due diligence
   b. Seller will not sell assets
   c. Seller will not create liens or encumbrances
   d. Seller shall resign as Operator and support Buyer as Successor Operator
   e. Seller shall request consents and waivers of preferential purchase rights
   f. Seller will deliver suspense funds to Buyer and provide a list of owners to Buyer
   g. Seller will provide Buyer a Preliminary Settlement Statement an agreed number of days before Closing

2. Buyer’s
   a. Buyer will notify Seller upon discovery of any breach of representations or warranties
   b. Buyer will have taken all actions necessary to become operator

C. Representations and Warranties

One of the customary conditions to closing is that the representations and warranties in the Purchase Agreement are true. One of the objectives of the due diligence review is to confirm that all such representations and warranties are true. The following is a list of representations and warranties commonly found in Purchase Agreements that will be part of the due diligence review.

1. Seller’s Representations and Warranties
a. **Organization/Existence/Qualifications**
   1) Seller is a _________ duly organized and in good standing
   2) Seller is qualified to own properties and carry on its business

b. **Authorization**
   1) Seller has power and authority to enter into this Agreement, perform its obligations under the Agreement and consummate the transaction

c. **Compliance with Laws/Permits**
   1) Seller has complied with all laws, rules, regulations, orders; and
   2) Seller has obtained and maintained all governmental permits, licenses and no violations exist with respect to permits and licenses

d. **Performance/No Violation** - the Agreement will not conflict with or result in breach of Seller’s bylaws or corporate documents, violate or constitute a default under any lien or encumbrance, or violate any statute, law or court order

e. **Approval** - no authorization, consent or approval from governmental authority or third party required to execute the Agreement or perform Seller’s obligations

f. **Pending or Threatened Litigation** - there are no pending or threatened suits, actions, claims against Seller, the properties or the operator of the properties.

g. **Taxes Measured by Production** - all ad valorem, production, severance, similar taxes due and payable prior to Effective Date have been paid, except those contested in good faith.

h. **Material Contracts** - Exhibit ___ contains a list of all contracts and agreements relating to properties, and Seller is not in default thereunder.
i. Preferential Purchase Rights: - except as disclosed on Exhibit _____, there are no preferential purchase rights, necessary third party consents, or similar restrictions on assignment.

j. Environmental Compliance –
   1) Seller has acquired all material permits, licenses, approvals in compliance with all applicable environmental laws.
   2) No environmental reports have been filed with governmental authority concerning release of any hazardous substance or violation of environmental laws.
   3) Seller has not incurred any liability under any suit, settlement, or judgment with respect to breach of environmental laws.
   4) The properties have not been used for storage or disposal of hazardous substances and Seller has not made any off-site disposal of hazardous substances from the properties.
   5) there are no underground storage tanks
   6) none of the assets contain any asbestos
   7) Seller has not entered into any consent order, decree, judgment that requires any material change in current operations with respect to or the present condition of the properties.
   8) there are no suits, actions, claims pending or threatened arising out of the violation or noncompliance of any environmental laws.

k. Gas Imbalances - there are no gas imbalances other than those listed on Exhibit _____.

l. Commitments - there are no outstanding commitments that require drilling or reworking operations, or obligations of Seller to make payments exceeding [$10,000] [$25,000] and Seller has not incurred or obligated for expenditures exceeding [$10,000] [$25,000] after the Effective Date through the date of the Agreement.
m. Material Facts
   1) Seller: All records and documentation furnished by Seller shall not be incorrect or inaccurate in any material respect and no documents were removed or information omitted which would make the date misleading in any material respect.

n. Operation of Properties and Condition of Equipment
   1) Since the Effective Date, the properties have been operated in a prudent manner, consistent with good oilfield practices and according to the operating agreement.
   2) Seller has not removed or exchanged any equipment without replacements of equal or better value.
   3) All equipment is operable and in reasonable repair, reasonable wear and tear excepted.

o. Insurance - Exhibit ____ lists all insurance policies which are and will remain in full force and effect until closing.

p. Tax Partnerships - None of the assets are owned under an agreement that elected to be treated as a tax partnership for federal income tax purposes.

q. Wells
   1) All wells have been drilled and completed on the properties or lands pooled therewith
   2) All wells are in compliance with allowables allocated thereto by applicable governmental entity.

r. Plugging of Wells
   1) All plugged wells have been properly plugged.
   2) There are no wells on the properties that are required to be plugged under applicable law
s. Operations

1) there are no agreements to deliver production at some future time without receiving full payment therefore.

2) all proceeds of production are being paid to Seller without indemnity other than the customary warranty contained in the division/transfer orders or gas sales contracts that have been furnished to Buyer and no significant portion of such proceeds are in suspense.

3) all royalties, shut-in royalties, minimum royalties, rentals have been properly and timely paid.

4) there are no claims or liabilities asserted against Seller under any material contracts.

5) there are no calls on, or options to purchase production.

t. Title

1) Seller has Defensible Title to the properties

2) Seller’s ownership of the properties, subject to Permitted Encumbrances, is such that:

   (a) Seller’s NRI is not less than that on Exhibit _______

   (b) Seller’s WI is not greater than that on Exhibit _______

       without a proportionate increase in NRI

3) Permitted Encumbrances:

   (a) royalties, overriding royalties, production payments, and reversionary interests, net profits interests, similar burdens that do not reduce the NRI on Exhibit ______.

   (b) preferential purchase rights and consents that have been waived or obtained or time period for asserting rights shall have expired.
(c) liens for taxes and assessments not yet delinquent or contested in good faith.

(d) liens under operating agreements

(e) rights of reassignment requiring 60 days or less notice

(f) easements, rights-of-way, surface leases in respect to properties, rights to consent by, notice to, and governmental entities customarily obtained subsequent to the sale.

(g) any other matter waived by Buyer pursuant to the Purchase Agreement (e.g. title defects).

D. Defects (Title and Environmental)

Title Defects will be discussed in more detail in Section XIII below.

1. Definition: “Title Defect” customarily means any lien, charge, contract, agreement, obligation, encumbrance, or defect of title that would cause title not to be Defensible Title, as that term is defined in the Purchase Agreement.

2. Defect Date: Date by which Buyer must assert any defects or is deemed to have waived the defect.

3. Subject to Deductible: For example, $5,000 per property and $250,000 in the aggregate

4. Subject to Threshold: For example, only if the amount is in excess of $250,000

5. Subject to Cap: For example, if aggregate amount of defects exceed $_____ or 50% of the value of a property or the purchase price, then Buyer may exclude property, terminate transaction or elect to take subject to defects

6. Right to Cure: Seller has right to cure within reasonable time, concede defect and adjust the purchase price, or dispute the defect
E. Assumption of Liabilities and Indemnities

The greater the liabilities that Buyer will assume, the greater care the Buyer must take to insure that it knows exactly the extent of those liabilities and how to quantify them. Typical liabilities that Buyers assume are: (i) the plugging and abandoning of wells, (ii) lease and contract covenants that must be expressly assumed by Buyer, (iii) post effective date environmental liabilities, and (iv) indemnification of Seller for liabilities both before and after the effective date. Therefore, the liabilities and indemnities and their limitations should be understood.

F. Conditions to Closing

The conditions to closing will constitute an important part of Buyer Closing Checklist. The due diligence review will determine whether most of these conditions have been met. Therefore, each condition to closing should appear on the master due diligence checklist. Closing is treated in more detail in Article XIV of the paper.

G. Termination

The team members responsible for the due diligence review should know when and how the transaction can be terminated. Buyers must be cognizant of the defect deadlines and closing deadlines. In addition, Buyers should avoid inadvertently creating an event (e.g. asserting defects that exceed a cap) that will permit the Seller to terminate the transaction if Seller decides that the properties are now worth a lot more than the agreed Purchase Price. If the Buyer finds a significant number of defects and wants to terminate the transaction, the Buyer needs to know when the contract termination threshold has been reached in order to terminate the due diligence program.

H. Exhibits

The due diligence review should confirm the completeness and accuracy of the information on the Exhibits. The 80/20 rule should not be used in this review as these Exhibits represent the universe of what is being sold. If an item is omitted from the Exhibit it will not be conveyed to the Buyer in the absence of coverall language in the conveyance. The due diligence team will confirm, among other things, the descriptions for the following:

1. Leases and Wells, together with applicable WI and NRI
2. Excluded Assets
3. Allocated Values

4. Material Contracts and Agreements

I. Disclosure Schedules

Preferential Purchase Rights

1. Consents

2. Pending Litigation

3. Liens and Encumbrances

4. Gas Imbalances

5. Insurance

VI. WHAT HAS TO BE REVIEWED

What has to be reviewed is generally a product of the variable types of risk the Buyer is willing to accept: title risk, environmental risk, operations, accounting, marketing and the nature of the properties. Each Buyer will have to determine for itself how much exposure to these risks it is willing to accept. To illustrate the variations of acceptable risk, a Buyer using his own funds for an acquisition, may certainly decide not to conduct any due diligence review if he chooses, while a Buyer using bank or equity financing capital must conduct a reasonable and adequate due diligence review. Each Buyer must assess its own measure of risk tolerance when planning the due diligence review. This paper assumes a reasonable due diligence inquiry.

A. Our Primary Objectives

1. To confirm the assumptions and information upon which Buyer’s offer was made and that there are not any undisclosed liabilities.

   a. Verify that the Seller owns title to the represented interests on the allocated value schedule and that those are the same represented interests used in any reserve report

   b. Identify all material contracts

   c. Review all material contracts for and brief the term of, as necessary:
1) restrictions on transfer or assignment 
2) reductions in represented interests 
3) unusual obligations that would have a material adverse effect 
4) operating agreements 
5) area of mutual interest, farmout and participation agreements 
6) marketing and transportation

2. Identify any restrictions on transfers and assignments 
3. Identify and evaluate potential/contingent liabilities, pending or threatened claims, lawsuit, environmental problems, and regulatory problems 
4. Verify that the descriptions applicable to material contracts and the properties in the Purchase Agreement and in conveyance documents are sufficient and accurate 
5. Review forms of conveyances 
6. Determine filing jurisdictions 
7. Review property descriptions for completeness to insure valid conveyances 
8. Understand the obligations, responsibilities, liabilities, and operations that Buyer will assume at the closing 
9. Prepare for Closing 
   a. Satisfy conditions to closing 
   b. Prepare or review closing documents 
   c. Verify permits, bonds and qualifications 

B. Defining the Scope
1. Conference to discuss Buyer’s goals and objectives. It is always for the client to
determine the scope of the due diligence investigation, together with the
attorney’s advice, and the benefits, costs and risks of different approaches.

2. How much do we look at – Do we use the 80/20 rule in all cases, or at all?
   a. Percentage and number of properties to be reviewed in land files
   b. Percentage and number of properties to be reviewed in county records
   c. Percentage and number of properties to be covered by title opinions

3. How closely do we look at it?
   a. Full land file review
   b. Cursory land file review
   c. Full county record search (from date of prior opinions)
   d. Cursory county record search (lien search/assignments into/out of Seller)

4. Are properties to be operated?
   a. Regulatory forms
   b. Bonds
   c. Disbursement responsibilities
   d. Billing responsibilities
   e. Compliance with contract covenants and laws

5. Are properties to be mortgaged? Then Design and coordinate plan with
   lender

6. Factors that influence the scope of due diligence
   a. Nature of the business
   b. Character of the properties
c. How strong are representations, is Buyer willing to rely on them and to what extent do representations survive the closing

d. Financial strength of Seller and Buyer

e. Relationship of the parties

f. Cost-benefit analysis based on size of the transaction, number of properties and concentration of value.

g. Time constraints

h. Risk tolerance - The amount of risk and liabilities to be retained by the Seller versus risk and liabilities to be assumed by the Buyer. Is an adequate amount of risk built into and discounted into the purchase price? What is Buyer’s acceptable risk profile?

VII. DOCUMENTING THE DUE DILIGENCE INVESTIGATION

A. Purpose

1. To document what was reviewed and discovered - (Why didn’t we know about this?)

2. May be the basis for defending claims against third parties

3. May be the basis for asserting claims for breach of representations and warranties by the Seller

4. Information gathered is useful in transition process

5. Information gathered is useful in the operation and administrations of the properties

B. Developing the Forms

The way the due diligence review is documented is important for several reasons. First, an effective and efficient way to capture data is necessary to;

1. provide information that is the basis for preparing defect notices
2. provide evidence of the scope of due diligence to protect against liability to lenders or investors

3. provide information about the properties that will be useful in operating and administering the properties after closing

4. satisfy prospective lender or investor requirements for due diligence

5. provide valuable information that will assist future Buyers with their due diligence

The form(s) should contemplate what specific data needs to be captured, who will be filling out the forms, who will be reading them, how will they assist the company in the operating and administrating of the properties after Closing. Specifically the forms should be designed so that:

6. information gathered is easily disseminated

7. information gathered can be useful in administrating properties after closing
   a. Identify properties with preferential rights to purchase and consent for future sales
   b. Brief of operating agreements and other material contracts
   c. Document and confirm record title working interests and net revenue interests

C. Types Of Due Diligence Documents

1. Data gathering documents - worksheets

2. Management Control documents - Checklists, Status Reports

3. Reporting Documents - Title Reports, Scope Letter

D. Due Diligence Documents

1. Due Diligence Checklists

2. Post-Closing Checklists to monitor post-closing issues
3. Due Diligence Reports
4. Acquisition Title Opinions
5. Lien Searches
6. Title Defect Notices
7. Due Diligence Memorandum/Scope Letter
   a. Define the scope of the due diligence review
   b. Describe the process
   c. Describe what was reviewed and generally by whom
   d. Summarize the significant or material issues and quantify
   e. Describe what was not reviewed. This is as important as what you did review

VIII. THE DUE DILIGENCE TEAMS (Areas of Responsibility and Functions)

There are essentially six (6) basic disciplines involved in an acquisition of oil and gas properties. Each discipline should have its own team and defined area of responsibility. There may be overlapping responsibilities between the teams on the materials to be reviewed, therefore a clear delineation of which team is to record and report information is critical to the process. Each area of responsibility team should be comprised of experts and specialists from the respective disciplines. Each of the areas of responsibility along with a basic checklist, or list of things to accomplish in each area, is listed below.

A. Accounting
   1. Lease Operating Statements - verify revenue and expenses including taxes, compression, transportation and lease operating expenses
   2. Lease Operating Expenses - determine types of costs with emphasis on costs paid to third parties
   3. Revenue Verification - verify prices, revenues and contracts
4. Compare revenue and expense divisions of interest to reserve report, JIB and revenue distributions
5. Compare overhead/well maintenance fees charged to joint interest owners with operating agreements
6. Review payments of personal property and/or ad valorem taxes
7. Review severance tax filings and payments
8. Review gas imbalances under operating and transportation agreements
9. Review joint owner accounts receivable - identify non-paying owners and if operator is netting any owner and why
10. Review gathering and transportation agreements and related revenue and expenses
11. Determine quantity of royalty owners and status of royalty owners as in a pay status or in suspense
12. Identify and review salt water disposal agreements
13. Obtain list of shut-in wells and confirm shut-in royalties have been timely paid
14. Obtain rental calendar
15. Identify and evaluate status of all open AFEs
16. Identify any prepayment arrangements
17. Identify all active operating, treatment or processing contracts, including, for example, compressor leases
18. Identify all wells with payout provisions and determine status
19. Obtain copy of all joint interest audits
20. Is Seller being netted by operators
21. Obtain equipment inventory
22. Review legal and minimum suspense ledgers
23. Review past 12 to 36 months of production history
24. Develop cash flow analysis
25. Identify and prepare an undeveloped acreage report
26. Obtain schedule of oil or gas in storage

B. Marketing
1. Review contracts (sales, transportation, processing, storage, construction and operations)
2. List purchasers
3. List transporters
4. List effective dates
5. List contract price(s)
6. List take-or-pay obligations
7. List unusual provisions, restrictions
8. Compare price(s) with those used in reserve report
9. Identify and evaluate gas imbalances
10. Identify nomination problems

C. Engineering/Operations
1. Reserve economics
2. Physical inspections
3. Personal property and equipment inventory
4. List of pumpers
5. Review well files
6. Review regulatory files for regulatory and environmental compliance
7. Agency reporting procedures
8. Verify production well status (a) Producing, shut-in, mechanical problems
9. Identify existence of wells not reported by Seller (P&A liabilities)
10. Confirm wells were permitted and drilled in compliance with regulatory and spacing rules
11. Confirm wells drilled timely and completed in proper zone
12. Identify onerous regulatory and environmental matters
13. Identify salt water disposal wells
14. Review Annual Salt Water Disposal Injection Reports
15. Determine status of pending AFEs
16. Insurance coverage

D. Environmental

1. Purpose
   a. To establish the “innocent purchaser defense” under CERCLA
      • Must make “all appropriate inquiry” into previous use and ownership of the property consistent with “good commercial or customary practices”.
      • The Phase I ASTM Audit.
   b. Does not necessarily protect Buyer from Superfund liability
      • If property acquired after the disposal of the hazardous substance; and
• If at the time of purchase the Buyer did not know and had no reason to know that hazardous substances were disposed of.

• Although Superfund excludes petroleum substances, a Superfund action is brought to remediate a pit contaminated with oilfield wastes which include contaminants not covered by the exclusion, e.g. benzene. The Buyer may have a hard time arguing that he did not know that hazardous substances were disposed of.

c. Assess the environmental condition

d. Determine the level of environmental risk

e. Evaluate possible constraints on planned use

f. To satisfy legal, practical and financial concerns

g. Permit the Buyer remedies under the Purchase Agreement

h. Evaluate the business risk - quantify the effect in terms of remediation, costs and liabilities under state and federal laws and regulations

2. Key concerns

a. On-site contamination and off-site disposal

b. Continuing violations

c. Restrictions on use

d. Potential liabilities

e. Can increase exposure to liability due to knowledge of violations and environmental conditions

3. Areas covered by the Environmental Audit

a. Review of seller’s environmental files and reports

b. On-the-ground inspections
• View all compressor sites
• View major pipelines
• View chemical storage sites
• View SWD wells
• View major tank batteries
c. Review of relevant administrative agency information
d. Confirm regulatory and environmental compliance
e. Interviews of seller’s employees and agency personnel
  • Consider the character, location and history of the property in defining the scope of the environmental due diligence

4. Use reputable, well established environmental consultants
a. Environmental consulting firm
b. The ESA certified landmen

E. Land
1. Preliminary Matters
a. Learn Something about the Seller’s organization, for example (i) the Seller’s website (ii) SEC Forms 10-K and 10-Q (iii) Dun and Bradstreet (iv) Buyer’s industry colleagues
b. Review the reserve report
   1) Become familiar with the properties
   2) Oil or gas
   3) Geographical and geological
   4) Operated and non-operated
5) Manipulate the data - sort by PV10% value, field, county/state
6) Don’t overlook properties with common title
7) Beware of depth limitations and behind pipe zones
8) Closely scrutinize PUDs

2. Steps for Conducting the Land and Title Due Diligence

a. Review the Purchase Agreement

1) Understand the definition of Title Defect
2) Understand the deductibles and thresholds, if any, but report everything
3) Identify the Title Defect Deadline
4) Understand representations and warranties and how long they survive closing
5) Understand conditions to closing
6) The PSA is the definitive property list and allocated values

b. Land File Reconnaissance

The purpose of the initial land file reconnaissance is, at the earliest stage possible, to evaluate the condition of the Seller’s files and records and to make a preliminary evaluation of the status of Seller’s title to the properties being purchased. The information obtained from the initial file reconnaissance will be used to help further define the scope of due diligence and plan and to staff the due diligence program. Instrumental to this initial phase of due diligence is the identification of any significant issues which might impact ongoing negotiations between Seller and Buyer and Purchase Agreement issues. An outline of this early phase of the due diligence program is as follows:

1) Orientation (lay of the land)
• Identify Seller's key personnel for land and title, operations, engineering, accounting, marketing, etc...

• Establish the procedures for asking questions, etc.

• Prepare Working Group List with names, phone numbers and areas of responsibility.

• Discuss with Seller’s key personnel the probable scenario of due diligence. This establishes good relations, removes the element of the unknown for Seller’s personnel and paves the way for future cooperation.

• Tour the land file room.

• Evaluate the land files – condition of files (quality and quantity), organization of files, manner in which the files have been maintained. Access to files. Procedures for checking out files and photocopies.

• Evaluate Seller’s computer systems - ability to generate reports, lease schedules, lists of contracts, consents, preferential purchase rights, well status; data conversion issues.

• Determine how to obtain access to building.

• Determine if arrangements be made for working after hours.

• Determine space availability and capacity.

• Determine access to and availability of telephones and Internet connections.

c. Title Reconnaissance - Based upon the time frame within which due diligence must be performed, gather information necessary to determine the following:

1) How many properties need to be updated in the counties

2) How far back it be necessary to update title
3) How many names need to be run in the county records

4) Geographic locations of the properties needing to be updated in counties

5) How many field landman will it require and field landman availability

6) Preparation of landman letters and organization of field landman

7) Pull the land files on all title update properties and obtain copies of the most recent title opinions, including any underlying title opinions upon which the most recent title opinions are based. Make sure you have identified the entire legal description of the property to insure complete title coverage. This is essential in updating the county records. Current division orders are one source of this information. In many cases it is advisable to provide copies of the division orders for aid in preparation of landman letters

8) Identify any assignments, contracts or events subsequent to the closing date of the most recent title opinions which affect Sellers’ title

9) Make sure a description of all of the leases, through which Seller's title is derived, is provided for preparation of landman letters

10) Inquire whether there are any existing mortgages or pending assignments which might require immediate action

11) Are there any title opinions in progress

12) Who holds record title

13) Who is the Operator of the properties?

14) Who has revenue disbursement responsibility?

15) Obtain a general history and chain of title to the properties being purchased. Were the properties generated in-house or were they
acquired by the Seller? If multiple Sellers, what is the general relationship between the Sellers? How was record title conveyed to the respective Sellers?

16) If Seller acquired its interest by previous sale:
   - Review PSA for unusual indemnities
   - Review for unusually long survival periods for obligations, indemnities, etc.
   - Unusual treatment of issues and defects such as high threshold and deductibles
   - Review Seller’s due diligence reports, asserted title defects and curative

d. Initiate the Acquisition Title Opinions (i) Identify the top properties to be covered (legal descriptions) (ii) Review prior opinions and obtain copies for examiners (iii) Decide on title examiners (iv) Give clear instructions to title examiners

e. County updates/lien searches/title opinions
   1) Involve field landman in the process of identifying common names and time periods to run if doing global county record searches, which is often the case where title opinions are not being prepared
   2) Landman Letters (See example in Appendix A)
   3) Runsheets

f. Initiate the Land File Review – Procedures
   1) List of properties - WI/NRI - Values
      - Identify properties from reserve report and/or allocated value schedule
   2) Pull all the files on the property
- Division Order file
- Title file
- Prospect/Area file
- Contract file
- Lease file
- Well file

3) Approach the files with idea that I need to understand the property

- What is it?; a unit, a lease well.
- Where is the value?; What zone(s) are there? (iv) Review Division Order file
- Current division order for legal description
- Verify net revenue interest (on what interest is Seller being paid)
- Identify purchaser, other working interest owners and royalty owners

4) Title File

- For copy of most recent title opinion for updates, current ownership and property descriptions
- Identify significant unsatisfied requirements and curative

5) Prospect/Area File

- See how the property came together
- Maps, plats, executive summaries, identify relevant contracts/agreements – look for AMIs
6) Review Contracts
   • For restrictions on transfers or assignments
   • Identify preferential purchase rights, consents and AMIs
   • Determine whether Seller is in breach of the contract
   • Unusual provisions that might have a material adverse effect
   • List the contracts reviewed and copy when necessary
   • Identify Contracts that expire prior to or immediately after Closing (x) Brief JOAs
   • Parties and interests
   • Contract Area
   • Change of Operator provisions
   • Preferential Rights to Purchase, and other restrictions on transfer
   • Describe AMIs – their duration, coverage and terms
   • Non-consent penalties – are their forfeitures?
   • COPAS Accounting Procedure – any changes from standard form?
   • Want are COPAS overhead rates
   • Expenditure limits

7) Lease files
   • Lease maintenance problems, partial termination clauses, Pugh clauses and continuous drilling obligations
   • Assignments
Assignments

Correspondence, landowner problems

8) Well Files

Location plats

Regulatory filings

AFEs

Well status

g. Identify any significant issues that need to be addressed in the Purchase Agreement, such as the existence of preferential rights to purchase, consents to assign and evidence of any third party claims, lawsuits, environmental or regulatory problems.

h. Compile list of names and addresses of purchasers of production (in order to prepare letters-in-lieu of transfer orders)

i. Preparation of Acquisition Worksheet and/or Title Report so that title issues are easily transferable to Title Defect Notices

j. Coordinate transition/conversion of data for disbursement of revenues and JIB billings

F. Legal

1. Outside Counsel

a. Drafting/Negotiating Purchase Agreement

b. Preparing Defect Letter

c. Preparing Closing Documents

d. Issues Legal Opinions (authority and performance)

e. Address corporate issues
• Authority
• Officers Certificates
• Corporate Existence
• Good Standing
• SEC
• Bonds to operate

2. Insurance
   a. Advise client of legal risks associated with legal issues, claims, liabilities, indemnifies, etc.

3. Local Counsel
   a. For confirming form and substance of documents are valid and binding in jurisdiction where properties are located
   b. For advice as to the law in other jurisdictions in connection with evaluating issues

4. Title Examiners
   a. Preparation of limited acquisition title opinions.
   b. For advice concerning title issues and evaluating title defects.

IX. STAFFING AND ORGANIZING DUE DILIGENCE PERSONNEL

Selecting the right people for the due diligence team can make the difference between a successful due diligence program and an unsuccessful one.

As a general rule, use Buyer’s in-house personnel. It is less expensive than hiring outside services and consultants and Buyer’s personnel will become familiar with the properties, which will expedite assimilation and administration of the properties after closing. However, as is often the case, if Buyer’s personnel lack the expertise and/or do not have the time needed to be dedicated to the process then Buyer will have to contract for outside services.
X. THE DUE DILIGENCE MANAGER’S RESPONSIBILITIES

The optimum due diligence model has a due diligence manager who oversees the process and coordinates the activities. This person can be a company employee or an outside consultant. The manager’s responsibilities include:

1. Logistics
   a. Establish a timetable for all activities
   b. Determine space availability/accommodations for due diligence team members
   c. Ascertain how many team members each function will require

2. Direct and manage the due diligence team
   a. Record keeping - manage the information and establish mechanisms to disseminate information to the appropriate personnel.
   b. Hold regular meetings, in person or by conference call.
   c. Coordinate with other Buyer’s departments and other team members. Encourage team approach, working together and sharing information.
   d. Maintain a list of tasks and responsible parties. Tasks and responsibilities should be assigned geographically and/or geologically.

3. Track Properties and Percentage of Value Reviewed Daily
   a. May need to staff up
   b. May need more time if you can’t staff up
   c. May need to re-evaluate and re-define the scope
   d. May need to reassign member of due diligence team
   e. Monitor costs on an ongoing basis
4. Evaluate and Communicate Issues as they come up
5. Develop use of forms jointly with team leaders
6. Coordinate exhibits and closing documents for closing
7. Manage post-closing obligations - The Post Closing Checklist
   a. Filing and recording the transaction documents
      1) Recording Schedule
      2) Circulate copies to the parties
   b. Performance of post-closing covenants in PSA
8. Transition
   a. Change of Operator - Regulatory Records
   b. Change of Operator - Under the JOA
   c. Assimilate files and records

XI. COORDINATION AMONG DUE DILIGENCE TEAMS

   Section VI. above discussed each of the areas of responsibilities of the due diligence teams. While each area of responsibility performs its own functions, there are several areas that have overlapping functions. The following is a list of various functions that may overlap with the land due diligence team.

   1. Accounting

      a. Revenue Deck and JIB Deck comparison with record title and represented interests (may be only way to flush out problems in lower value properties)
      b. Delay Rental and Shut-in Payment Schedules
2. Marketing
   a. Names/Addresses of purchasers of production for letters-in-lieu of transfer order

3. Operational/Environmental
   a. Allowables
   b. Ingress and egress problems
   c. Unusual surface restrictions and requirements
   d. Evidence of environmental problems

4. Legal
   a. Title and environmental defects
   b. Issues that could impact negotiations
   c. Title Opinions

In virtually every acquisition someone on the Sellers side will say:

   someone on Buyer side already reviewed that or I’ve already provided that information to someone on Buyer side

The fact is, some matters need to be reviewed from different perspectives and for different reasons and will, therefore, have to be reviewed more than once. However, understanding where overlapping functions may occur and coordinating the due diligence teams accordingly will create an efficiency in the process.

XII. HANDLING DEFECTS

A. Issues that are not typically Title Defects
Issues relating to the following are, under typical definitions, not Title Defects. They can nevertheless have a significant adverse effect on the value of a property. Therefore, these items should not be overlooked in the due diligence review.

1. Ingress and egress to the property
2. Allowables and spacing
3. Landowner claims - not yet the subject of litigation
4. Undisclosed gas imbalances

B. Asserting Defects

A defect is a contractual concept derived from the Purchase Agreement which defines what a “Defect” is and what are the agreed remedies. Preparing Defect notices and the process of asserting them must be conducted precisely in compliance with the Purchase Agreement. Buyer’s personnel must therefore review and become thoroughly familiar with the provisions of the Purchase Agreement that set forth (i) the definition of Defects, (ii) whether certain deductibles, thresholds and caps apply, (iii) how Defects are to be described, supported and asserted, and (iv) the deadline for asserting such Defects.

Since notices of Defects are highly technical and must be drafted and submitted in strict compliance with the terms of the Purchase Agreement, it is recommended that only persons experienced in this area handle the preparation of Defect notices and/or any responses thereto. Buyer should consult with its title attorney with respect to any title Defects and Buyer’s environmental consultant with respect to environmental Defects for assistance with evaluation of the issues, the description of a Defect and the value to be assigned to a Defect.

The Buyer must also formulate a strategy for asserting Defects, if the Defect amount for an individual property, or the aggregate value of all Defects, exceeds a Purchase Agreement cap that will trigger an election by Seller to remove the property from the sale or terminate the entire transaction. If there are numerous Defects, Buyers may have to be selective about which Defects to assert. Buyer’s strategy should involve not only the assessment of risk associated with a Defect, but also other economic and business issues that the Buyer may have with respect to the transaction as a whole.

Generally, Buyers should be very liberal in determining what issues constitute Defects and very liberal in asserting them in order to preserve their right to claim a Defect.
Buyer can always waive a Defect later, but will likely be deemed to have waived any claim for a Defect after the Defect deadline. The exception to this general rule is where there are so many Defects that Buyer runs the risk of exceeding a Purchase Agreement cap.

The typical criteria under a Purchase Agreement for asserting a title Defect are:

1. The issue must meet the definition of a Defect
2. The Defect must meet the deductible (e.g. the value attributable to the Defect must exceed $5,000 with respect to an individual property)
3. The sum of all Defects must exceed the threshold (e.g. $250,000 or 10% of the total purchase price)
4. The sum of all Defects must not exceed the cap (i.e. Seller’s option to remove a property from the sale if the Defect Amount exceeds, for example 50% of the value of the property, or to terminate the entire transaction if the total value of all Defects exceeds, for example, 20% of the total purchase price). Note: This has been called from time to time the “Nuclear Option” by Buyers who want “out” of a transaction.

C. Seller’s Response to Defects

Sellers are almost always in control of the remedies for Defects and should always prepare a formal written response to all asserted Defects. In many Purchase Agreements failure of the Seller to respond to asserted Defects can be considered an acknowledgment of the Defect which will entitle the Buyer to a purchase price adjustment and will waive any rights the Seller may have to cure or dispute the Defect.

Purchase Agreements are often not specific about the form of Seller’s response to Defects. The response should however, address in particular detail, each specific Defect and state whether the Seller:

- intends to cure the Defect
- accepts the Defect and agrees with the Defect Amount
- accepts the Defect and disagrees with the Defect Amount
- disputes all or part of the Defect
1. Disputing the Defect

Defects can be disputed and challenged for two reasons. First, that it was not properly asserted pursuant to the provisions of the Purchase Agreement (i.e. it does not meet the deductible or the threshold) or, second, that the Defect does not meet the definition of a “Defect” under the Purchase Agreement. In a case where a portion of Seller’s represented interest is actually owned by a third party, the title Defect may be undisputed, but many other exceptions to title that are asserted as title Defects may be strongly contested. Buyer may need the help its title attorney and environmental consultants to provide support for Buyer position when Seller disputes Defects.

2. Disputing the Defect Amount

The formulas and mechanisms in the Purchase Agreement for determining the Defect Amount, if there are any, are rarely adequate to determine accurately the monetary value of a Defect. For example, the formula used to calculate the Defect amount for a property whose actual ownership interest is 25% less than the interest that was represented may be straightforward (property’s allocated value x 25%), while the Defect amount attributable to an unreleased lien however, is not usually the total value of the property, but may instead be the actual cost associated with paying off the indebtedness or obtaining and filing a release of the lien. Also, a more accurate measure of the Defect amount attributable to a reduction in Seller’s interest after payout is usually not an adjustment based on an affected interest’s discounted time allocated value, but instead may require re-engineering of the property’s economics.

D. Negotiating Defects

Often a Purchase Agreement contains no formal definition of a title defect. Rather, the Buyer is required to notify Seller of any matter that would cause Seller’s title to any of the properties not to be Defensible title. In addition, the Purchase Agreement may not contain any or an adequate method for computing the value of Defects. Most often the negotiation of Defects is a significant part of the transaction and the information obtained during due diligence is critical to this process.

Buyers often determine their position with respect to Defects by evaluating the risks. This process often includes input from lawyers, engineers, accountants and other technical and business personnel. Factors considered are: (i) the nature of the issue, (ii) the source of title and the length of time a property has been producing, (iii) whether a
title Defect may have been cured by adverse possession, and (iv) the likelihood a claim may be asserted by third parties, such as missing or unknown heirs or entities that no longer exist because of merger or dissolution. Once Buyer has evaluated each risk, it will be in a better position to allocate and/or accept those risks. Some risks may be allocated by the assumption of liabilities and indemnifications, some by purchase price adjustment, and others assumed with little or no business risk. Future relations with the Seller should be considered especially if a continuing relationship is important to the Buyer after Closing.

Regardless of the nature of a title Defect, where Seller has received the economic benefit from a property over a long period of time and expects to continue to receive it, the Seller will strongly resist any significant reduction of the purchase price attributable to the property.

Negotiating title Defects is complex and will not be thoroughly addressed in this paper. However, the following are a few strategies Buyers and Sellers typically use in negotiating a resolution of these issues:

- Trade off for other business issues
- Indemnification against any future claims
- Escrow allocated purchase price pending curative
- Agree on a compromise adjustment amount
- Arbitration of Defects

XIII. IF THERE IS FINANCING, COORDINATING DUE DILIGENCE WITH FINANCING SOURCE

If financing of the acquisition is contemplated, the lender or equity investor will have its own due diligence review requirements. These requirements will depend on, (i) the type of financing that will be put in place, (ii) the risk tolerances of the lender or investor, and (iii) the terms of an existing Credit Agreement if one is already in place.

Virtually all lenders or investors will rely on the due diligence review conducted by the Buyer in connection with its acquisition and will permit the Buyer to direct the review if it is consistent with their standards. Buyers should collaborate with their lenders or investors at the outset to insure that the scope and limitations of Buyer’s due diligence review are acceptable. It
is not uncommon for the Buyer to fail to adequately consult with the lender, for example, until
the due diligence review is almost completed only to find out that its due diligence is not
sufficient. Then the due diligence team will likely have to go back and search for information
that could have been captured during the initial process. This situation could have disastrous
results if the Buyer is facing a required close date and the lender will not fund until its due
diligence requirements are met.

The following are due diligence requirements important to the lender that may be commonly
overlooked, or waived, by a Buyer:

1. UCC Searches – While Buyers will conduct a “lien search” in the county public
   records, they frequently overlook or waive a UCC search at the central filing
   jurisdiction, or Secretary of State’s office in the names of the Sellers.

2. OCS Leases – Buyers may only conduct title searches at the office of the Bureau
   of Ocean Energy Management (“BOEM”) because title to OCS Leases must be
   approved by and perfected at the BOEM. However, liens are filed and perfected
   in the coastal counties or parish records. Lenders will require county/parish lien
   searches and will usually require a limited county/parish title search to confirm
   that the OCS Lease and its complete chain of title are also filed in the
   county/parish records.

3. Percentage of value reviewed – Although reviewing at least 80% of the value is
   the generally accepted practice for both Buyers and lenders, there are factors that
   can make reviewing 80% of the value impractical to achieve. To achieve the
   most efficient due diligence process, Buyers and lenders must agree early in
   process on the appropriate percentage of value to review.

XIV. PRE-CLOSING, CLOSING AND POST-CLOSING.

A. PRE-CLOSING - Preparation and Review of Exhibits

The property descriptions to be attached to the conveyance and financing documents
should be reviewed by the land and title due diligence team as these are the most familiar
with the properties. If possible, they should be reviewed during the land and title review.
Unfortunately, in most cases the land and title review is near completion before the
property descriptions for the conveyances are available. It is wise, therefore, to plan a
last minute rush to confirm the completeness and accuracy of property descriptions,
which may also reflect last minute changes resulting from the final due diligence report
of from properties being added or removed from the sale.
If appropriate, the 80% Rule may be used for confirming the accuracy and completeness of the information in the property descriptions, relying on the further assurances clause to correct description problems in the lower tier properties. Nevertheless, the Buyer should confirm that it has a property description for all properties included in the sale and that the working interests and net revenue interests, if represented, are all consistent with the interests represented in the Purchase Agreement.

B. CLOSING

1. The Purchase Agreement
   a. Closing time and place
   b. All representations are true
   c. All conditions to close have been met
   d. Covenants pending closing – delivery of documents

2. Closing Checklist Seller’s Documents
   a. Preliminary Settlement Statement (e.g. 5 days prior to closing)
   b. Seller’s Corporation Certificates
      1) Compliance Certificate
      2) Certificate of Organization
      3) Certificate of Good Standing
      4) Affidavit of Non-Foreign Status
   c. Seller’s Opinion of Counsel
   d. Assignment and Bill of Sale
   e. Letters-in-lieu of Transfer Order
   f. Change of Operator Forms – Regulatory (e.g. P-4 in Texas)
g. Resignation of Operator Letters (under the JOA)

3. Closing Checklist – Buyer’s Documents
   a. Buyer’s Certificates
      1) Compliance Certificate
      2) Certificate of Organization
      3) Certificate of Good Standing
   b. Buyer’s Opinion of Counsel
   c. Evidence of Plugging and Operator Bonds
   d. Wire instructions/Funding

C. POST-CLOSING

1. Post-Closing Checklist
   a. Seller to deliver files and records promptly
   b. Buyer to file Assignments (within 15 days after closing)
   c. Buyer to provide Seller with recorded copies (as soon as available)
   d. Seller to provide Final Settlement Statement (e.g. 120 days after closing)
   e. Buyer’s exceptions to Final Settlement Statement (30 days after Final Settlement Statement)
   f. Final post-closing adjustments (10 days after Buyer’s 30 days)

2. Delivery of executed closing documents and possession of the assets

3. Selection of new Operator under Joint Operating Agreements

4. Post-Closing Notices and Consents
5. Accounting adjustment – Final Settlement Statement
6. Assimilate files, records, administration

XV. SCHEDULING AND OTHERWISE ADDRESSING SHORT TIME FRAMES

Up to now, this paper has addressed organizing, executing, and other fundamentals of the due diligence review, but not yet how to get it done… Quickly!

However, the more organized the processes and the more quality and quantity of resources that are brought to bear; the quicker the due diligence can be executed and completed. In a practical sense, consider the timeframe allotted for due diligence, then acquire the right expertise, mobilize as soon as you can, and constantly focus on the Buyer’s goals and objectives for due diligence set forth in detail above that can be realistically accomplished with the time and resources available. On the other hand, if you don’t know where you are going, you will be lost when you get there.

XVI. CONCLUSION

Although a good due diligence program should be well-structured, it must be kept in mind that due diligence is a fluid process that must be constantly tuned and re-directed in order to achieve Buyer objectives within a reasonable time, at a reasonable expense, and with the resources available. Successful due diligence will belong to those who:

- have expertise in the areas that need to be investigated
- are flexible, can think quickly on their feet, and make decisions quickly
- are creative and find innovative ways to organize and streamline the process
- are able to focus on the issues that are important to the objectives of the process
- are able to effectively interface with the other disciplines on the due diligence team.

For a bottom line short acquisition due diligence program, the following is a list of the minimum areas of investigation; assuming this list it is appropriate for the transaction:

- Verify title based on an in-house file review and public record searches
• Determine whether there are any restrictions on transfers; preferential rights to purchase and consents to assign

• Address change of operator issues, both contractual and regulatory

• Conduct an accounting overview; reconcile DOIs and JIBs with record title, disbursement obligations and transfer of data to Buyer company’s systems

• Conduct an environmental review; field inspections and regulatory violations

• Evaluate the marketing and transportation contracts

• Confirm that the conveyance documents and exhibits are correct
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APPENDIX A
SAMPLE LANDMAN’S LETTER

RE: Preparation of Runsheet:

____________ Parish, Louisiana

Dear ____________:

In accordance with our telephone conversation, this letter is our request that you undertake an examination of the records in the office of the Parish Clerk of __________ Parish, Louisiana, as those records pertain to the property and entities described below. This examination is to assist us in the preparation of updated Title Opinions for ________________ covering the undivided interests in the property set forth below to be acquired by ________________ from ________________.

The description of the lands under examination, the oil and gas leases affecting these lands, the commencement date of your record examination, and the names of the record title owners of the oil and gas leasehold estate as of such commencement date as to which title is to be run are as follows:

Property Description:

Oil and Gas Leases:

Commencement Date:

Name of Record Title Holders as of Commencement Date:

Name of Operator:

Please prepare a run sheet listing all title instruments affecting the oil and gas leasehold estate in the referenced Property in the names of the Record Title Holders, and Operator, as well as the names of all assignees or successors of such parties, in the direct and reverse indices of the records identified below from the Commencement Date to the present. In addition, please examine the Conventional and Judicial Records in the names of the Record Title Holders and their successors and assigns for the past ten years. Finally, you should examine the Mortgage Records in the name of the Operator to determine
whether there are any notices of privilege filed pursuant to La. R.S. 9:4861, et seq. If your examination shows that any indicated entity has mortgaged or encumbered its interest in the oil and gas leases, please run the name of the bank and trustee to determine whether the encumbrance has been released.

In addition, we have determined from prior title opinions covering the captioned property that the following unreleased liens and encumbrances burden the oil and gas leases and/or property:

1. 
2. 
3. 

Your review of the records should include an examination of both the direct and reverse indices of the following records, as well as any other relevant records maintained by the Parish Clerk and Clerk of Court:

Conveyance Records
Oil and Gas Lease Records
Mortgage Records
State Tax Lien Records
Federal Tax Lien Records
Lis Pendens Records
Chattel Mortgage Records
UCC Records
Mechanics' and Materialmen's Lien Records
Abstract of Judgment Records
Succession Records
Daily Register
Miscellaneous Records
Clerk of Court Records (Civil Suits)

The Operator should be run only in the following parish records:

- Mortgage Records
- State Tax Lien Records
- Federal Tax Lien Records
- Lis Pendens Records
- Chattel Mortgage Records
- UCC Records
- Mechanics' and Materialmen's Lien Records
- Abstract of Judgment Records
- Daily Register

Clerk of Court Records (Civil Suits)

At your discretion, you may use the local abstractor's records if you feel that these records are reliable and complete. Please indicate on your runsheet whether the search was conducted from the abstractor's or Parish and District Clerk's indices.

Please provide us with a runsheet listing all of the documents relating to the property, leases, and names indicated above. Your runsheet should set forth the property, leases, and names covered as well as the records reviewed and the dates covered by your examination. Please provide us with photocopies of all instruments listed in the abstract and any unit designations affecting the property, whether recorded during the above stated period or otherwise.

We understand that you have agreed to provide land services at the per diem rate of __________ plus out-of-pocket expenses. Please arrange for the Parish Clerk and Clerk of Court to invoice us directly for all photocopying and tax certificate charges. Any such invoices, as well as your invoice, should be addressed as follows:
In order to complete our title opinions in a timely manner, we must receive the results of your search no later than __________. Should you experience difficulties that would cause you to be unable to meet this deadline, please call me, telephone number (____)__________, so that any problems can be discussed and solved promptly.

Your prompt attention to these matters is of utmost importance, and thank you in advance for your assistance.

Very truly yours,