Top 10 Considerations for Oil and Gas Asset Transfers

As the market heats up this summer, we compiled a "Top 10" list of common issues that we recently have encountered in representing Buyers and Sellers in transfers of oil and gas related assets in Oklahoma. While this list does not reflect every issue that might be considered in negotiating and drafting a Purchase and Sale Agreement ("PSA"), it should serve as a useful guide for parties contemplating transactions this deal season.

1. **Asset Descriptions.** Early in the negotiation of the PSA, care should be taken by both Buyers and Sellers to ensure that the PSA accurately and completely describes the assets being transferred—either through disclosures in the body of the PSA itself or in the accompanying exhibits and schedules. While this may seem obvious, ancillary assets can easily slip through the minds of management as negotiations on other issues progress, only to be discovered at the eleventh hour before closing. As it is often the case that the Seller is in the best position to prepare such a list, the Buyer should carefully review the list to ensure that the assets listed therein accurately reflect any preliminary diligence conducted by the Buyer's representatives. For E&P transactions, it is often important to address any drilling equipment, storage tanks, specialty tools, separation facilities, drilling logs, records and permits relating to the E&P assets. For midstream transactions, meters, valves, compressors, cathodic protection equipment, records, surveys, maps, real estate and easements should often be considered in addition to the underling pipeline.

2. **Contract Assignability.** While not often on the minds of Buyers and Sellers at the time of executing a letter of intent, there are usually rights under several agreements relating to the Seller's use, maintenance and operation of the subject assets that the Buyer will want to acquire through the transaction. While these contracts are often included as part of the definition of "Assets" being transferred in the PSA, we specifically take note of these assets, as extra diligence is often required to ensure that the Buyer is able to "step into the shoes" of the Seller in these contracts at closing. In E&P transactions, gathering, processing, joint operating, pooling, participation agreements and other agreements setting forth "areas of mutual interest" for development will often need to be carefully reviewed by counsel to ensure the assignability of the Seller's interests under those agreements. In midstream transactions, gas purchase agreements, storage agreements, communication tower leases and other commercial agreements relating to the transportation and measurement of hydrocarbons in the pipeline will also need to be reviewed by counsel with an eye toward assignment and change of control provisions.

3. **Preferential Rights to Purchase.** Both Buyers and Sellers should examine any rights of first refusal, tag along or other preferential rights that third parties may own with respect to the subject assets. In oil and gas related assets, these rights are often included in operating, participation and joint venture agreements. The Seller is likely in the best position to determine whether any such rights exist and, as such, is often required to represent and warrant that no such rights exist or, if they do exist, that they are disclosed to the Buyer and that the appropriate third parties received all requisite consents or notices of the current transaction pursuant to such rights. Identifying and evaluating these rights early in the negotiations will reduce the risk of a delayed closing or a significant change in the assets that may be purchased by the Buyer.

4. **Environmental Liabilities.** Given the risk of significant liability, the PSA should provide a clear mechanism of risk allocation between the Buyer and Seller with regard to environmental defects (or claims) arising out of, or relating to, the oil and gas assets—both before and after closing. Buyers often request, as part of their diligence, the right to conduct nonintrusive environmental reviews related to the assets prior to closing. Results from any such reviews should be delivered to the Seller and otherwise prohibited from disclosure, but should assist the parties in risk allocation.

5. **Governmental Approvals.** Given the highly regulated nature of oil and gas assets, both Buyers and Sellers should consult with counsel regarding any regulatory approvals necessary to complete a transaction. Additionally, transactions involving assets located on tribal lands may require special approvals from tribal authorities. With E&P transactions, if the Buyer desires to be appointed as the operator of the assets post-closing, the Seller should have an affirmative covenant to assist the Buyer in filing the requisite documents with the Oklahoma Corporation Commission to effect the change in operator status. In the midstream sector, the transfer of interstate pipelines could be subject to review and approval by the Federal Energy Regulatory Commission. Also, a transfer of intrastate pipelines could be subject to review and approval from appropriate state regulators. Depending on the nature of these governmental reviews and/or approvals, the parties may consider whether such approvals are conditions to closing the transaction.

6. **Taxes.** The parties should be aware that the purchase and sale of certain assets in Oklahoma could subject the Buyer to liability for the payment of sales tax, which would be derived from the purchase price for the affected assets. In E&P transactions, the transfer of mineral interests alone are unlikely to be subject to the payment of Oklahoma sales tax; however, as is often the case, when personal property is also associated with those interests (e.g., rigs, equipment, tools, etc.) and included in the transfer, it could trigger an obligation to remit sales tax. The parties should independently seek advice from their counsel and accountants in order to best address these sales tax concerns. In the event that sales tax will be assessed on the transfer, the PSA should contain a provision setting forth a clear allocation of tax payment obligations between the Buyer and Seller. Absent such a provision, Oklahoma law provides that the Seller must add the sales tax to the purchase price, collect the sales tax from the Buyer and report and remit the collected sales tax to the Oklahoma Tax Commission. Under Oklahoma law, the Seller acts as a collecting agent for the state (and city), so the Seller's failure to collect, report and remit the sales tax on the sale could subject it to liability for such tax.

7. **Title.** For mineral interests and real estate assets (including easements), the parties should determine the level of title that the Seller will warrant to the Buyer. Under Oklahoma law, "marketable title" is often considered the gold standard; however, it is more often the case that the Buyer will consider the lower standard of "defensible title" as sufficient. Because Oklahoma law does not define "defensible title," the parties are left to define the types of defects that will rise to an indemnifiable claim under the PSA.

8. **Royalty Litigation Settlements.** With the increase in litigation between royalty owners and producers, we have seen an increase in concern by Buyers of E&P assets that the obligations imposed on Sellers by virtue of these settlement agreements will "run with the assets." Any such settlement agreements should be reviewed by Buyer's counsel early on in negotiations in order to determine if the obligations therein would, in fact, impose obligations on the Buyer (as a successor in interest to the assets). As these agreements may describe particular payment methodologies with regard to the distribution of production proceeds to royalty interest holders, Buyers will need ample time to evaluate these requirements in order to determine their impact on the economic feasibility of the transaction, given the Seller's valuation of the assets. Additionally, the parties should consider setting forth in the PSA the allocation of risks and obligations between the Buyer and Seller relating to these settlements.

9. **Employees.** As part of the transaction, the Buyer may desire to acquire the right to offer employment to one or more of the Seller's employees who have historically operated and maintained the assets. Including these employees in the underlying transaction allows the Seller to avoid relocating or reassigning employees to other projects post-closing who were previously dedicated to servicing the transferred asset. It also allows the Buyer to obtain the benefit of the knowledge gained by these individuals as employees of the Seller and reduces the risk of problems associated with the transfer and operation of the assets by the Buyer post-closing. In negotiating the PSA, the Buyer and Seller should discuss several considerations in connection with these employees, including (i) the duration of time that the Buyer will be able to make offers to the employees; (ii) whether the Seller will be allowed to retain employees that do not accept offers of employment with the Buyer; (iii) the amount of compensation that will be offered to the employees; (iv) the benefits that will be offered to the employees and whether any credit should be given for an employee's participation in the Seller's benefit plans for purposes of eligibility, vesting and awards; and (v) whether credit should be given to the transferred employee for any vacation or sick leave time that the employee accrued when employed by the Seller.

10. **Transition Services.** Often, at the time of closing an oil and gas transaction, the Buyer will not have the resources necessary to immediately operate the assets in the way previously operated by the Seller prior to closing. This is often the case when the Buyer does not retain any (or few) of the Seller's employees post-closing. In order to allow the Buyer to get "up to speed" in its operation of the assets, Buyers will often request that the parties enter into a Transition Services Agreement, contemporaneous with the closing of the underlying asset transfer. These agreements are typically short in duration and provide that the Seller will continue to operate certain aspects of the assets for a negotiated period of time and, in exchange, the Buyer will reimburse Seller for certain costs the Seller incurs during the term of the agreement. These agreements provide the Buyer time to recruit skilled employees, or to relocate its current employees, in order to properly operate and maintain the assets. In the oil and gas industry, these agreements are often particularly useful to Buyers when the transferred assets are located within geological plays where the Buyer has not historically maintained operations.

If you have any questions about this article, please contact one of the authors listed below or the GableGotwals lawyer with whom you usually consult.

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