

CAPLA LUNCH 'N LEARN

November 15, 2010

A&D

Contractual Issues and Process

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Major Documents Summary

- Confidentiality Agreement (CA)
- Letter of Intent (aka Offer to Purchase) (LOI)
- Formal Agreement
 - Purchase and Sale Agreement (PSA)
 - Asset Exchange Agreement
 - Conveyance
- Specific Conveyances

Confidentiality Agreement (CA)

- Not always used in A&D
- Almost always required prior to entering a data room
- Also used for farmin and other arrangements when confidential information shown to a third party
- Protection for vendor prior to disclosing information to purchaser

CA - continued

- Kind of a difficult idea
- You are asking your competitors not to use information they see against you:
 - in subsequent Crown postings
 - in top leasing
 - in buying other assets or companies

CA - continued

- Only applies to truly confidential information (not in public domain)
- Merely provides a right to sue, does not make people honest
- Rarely enforced

Letter of Intent (LOI) (aka Offer to Purchase)

- Why bother? Why not just go straight to a PSA?
- Sets out major business terms
 - price
 - assets
 - timing
- Sets out some important legal terms, such as conditions precedent

LOI - continued

- Very often LOIs are merely an “agreement to agree”
- An agreement to agree is an unenforceable contract
- Terms like “subject to the parties entering into a mutually agreeable form of PSA” indicate an agreement to agree
- Still useful as a LOI moves the business deal along

PSA

- Contemplates a transfer some time in the future, therefore may deal with:
 - a Closing Date and/or Closing Time
 - conditions to obligation to close
 - interim operations

- Requires a subsequent general conveyance at closing plus specific conveyances

CONVEYANCE

- Transfer occurs on execution and delivery
 - no conditions to closing
 - no interim operations
 - is dated as of Closing Date

- Only need additional specific conveyances

PSA – Major Terms and Conditions

Deposit

- Intended to be “guarantee of performance”
- Liquidated damages vs. penalty
- Purchaser wants language that:
 - deposit is liquidated damages for the entire claim
 - recoverable if vendor is in default, regardless of whether purchaser is also in default
- Vendor wants right to keep deposit as damages, even if it sells the assets immediately for an increased purchase price

Allocation of Purchase Price

Assets are Typically Divided Into the Following Categories

Petroleum and Natural Gas Rights	=	COGPE
Tangibles	=	CCA
Seismic [rare]	=	CEE
Miscellaneous	=	\$1

- Divided this way for tax purposes. Really has nothing to do with the A&D part of the deal
- Typically an 80/20 split, unless you have:
 - Undrilled lands (then 100% PNG Rights)
 - Tangible heavy assets (like a big gas plant), in which case the 20% tangibles allocation will go up

GST

- 5%. Payable only on price allocated to tangibles, miscellaneous interests and (sometimes) seismic
- Remember that oil and gas companies get GST back since they are not an end consumer. So GST is paid and then credited back. Not a cost, simply time value of money.
- Joint Election not to pay GST can be made on the sale of a business. Companies split on whether this applies to an A&D deal. I think it does not, but it does not really matter
- What about HST in BC ??

EFFECTIVE DATE vs. CLOSING DATE

- This one drives me crazy.
- “Closing Date” is when risk, possession and title pass:
 - affects insurance (insurable interest only when you own something)
 - affects physical operatorship of assets. Obviously cannot physically operate until you actually are doing so
 - is the date on the closing conveyance. Signed at closing
 - is a defined date in the PSA.

EFFECTIVE DATE vs. CLOSING DATE (cont)

- “Effective Date” is the date chosen to settle accounting matters as between the vendor and purchaser only:
- “as if” vendor had sold and purchaser had bought on the effective date
 - Purchaser:
 - gets accounting credit for all revenues from the effective date
 - pays all costs (rentals, royalties) from the effective date
 - Vendor:
 - usually gets credit for interest from the effective date (“as if” they received the purchase price)
- is a defined date in the PSA

EFFECTIVE DATE vs. CLOSING DATE (cont)

- “Effective Date” is not the effective date of the sale for third party purposes
- Third parties never need to go back and do accounting or anything else just because a joint venture partner says a PSA was “effective” six months ago
- Third parties to any contracts are bound to update records only upon novation

EFFECTIVE DATE vs. CLOSING DATE (cont)

- Novation occurs:
 - Upon the binding date in NOAs
 - first day of second full month after receipt
 - plus 20 days for deemed consent
- Upon full execution (including counterpart pages for A&Ns)
- Upon receiving notice or 1st day of next month for most other agreements

EFFECTIVE DATE vs. CLOSING DATE (cont)

- Soooo, in an NOA, what is the correct:
 - “Transfer Agreement” date
 - “Transfer Date” (conveyed *effective* ____)
 - Execution date at the end of the NOA

- Example:
 - PSA dated November 15, 2010;
 - Effective date September 1, 2010; and
 - Closing Date December 1, 2010

EFFECTIVE DATE vs. CLOSING DATE (cont)

- Correct answer is that the dates at the top do not matter, only the binding date matters to third party assignors (including the operator) who receives the NOA

CONDITIONS PRECEDENT TO CLOSING

- Usually for Purchaser's benefit
- Essentially creates an option to close until satisfied or waived
- Typical examples
 - Financing
 - Board of Director's approval
 - Environmental review
 - Field inspection (tangibles review)
 - Sometimes title review

- Vendor only really cares about getting paid. This is always a Vendors condition precedent to closing

REPRESENTATIONS AND WARRANTIES

- Promises that the Vendor and Purchaser make to each other
- Get to sue if the promise is broken
- Risk allocation philosophy
- What can we actually promise philosophy
- Time limited promise (typically 6 months to 2 years)
- Otherwise, oil and gas sales are “as is where is”
 - which is why you do title opinions

Representations and Warrants

Issue	Searches	Representation
1. Title	Land Titles Dept. of Energy PPR WCB Municipal Taxes Bankruptcy	-right to sell -no encumbrances; by, through and under -no notice of default
2. Corporate Status and Authority	Corporate Registry Court House	-deal with authority to sell -withholding taxes

DUE DILIGENCE CONT'D

3. Condition of Assets and Operations	Physical inspection ERCB information LLR Rating	-operations within good oil and gas practice -qualifications for license transfers
4. Financial Matters	Dept. of Energy	-payments of rents and royalties -no AFE's, unit equalization payments -no gas balances, over-production, etc.

DUE DILIGENCE CONT'D

<p>5. Environmental</p>	<p>Physical inspection ERCB Review internal and operator's records where available Environmental Law Centre searches by company name for breaches of terms of permits</p>	<p>-no knowledge of environmental breaches -no receipt of demands or notices which remain unresolved</p>
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DUE DILIGENCE CONT'D

6.	Contractual Obligations	Review vendor's records	<ul style="list-style-type: none">-gas processing-marketing-transportation-ROFRs-AMI and Areas of Exclusion
7.	Employment Issues	Employment Standards Office	<ul style="list-style-type: none">-no unions-if assuming employees, need comfort level re remuneration and severance

INDEMNITIES

- Distinction between liability and indemnification
 - liability relates to direct loss and damages
 - indemnification relates to third party claims

- Losses covered
 - breach of representations and warranties (time limited)
 - failure to perform

- Purchaser indemnity post closing
- Purchaser environmental indemnities pre and post closing
- Vendor indemnity pre-closing ??

CLAIMS

Claims for Misrepresentation or under Indemnity

- Limits on liability (sometimes limited to purchase price)
- Limits on time in which to make the claim
 - *Limitations Act* (2 years)
 - Industry Agreement re *Limitations Act* (4 years)
- Reliance requirement

PRE-CLOSING CONSENTS

- Investment Canada
- *Competition Act*
- LLR compliance for ERCB
 - Void transaction if not 1.0 post closing
- LLR compliance for SER
 - Not quite void, but still needs to be addressed pre-closing

PREFERENTIAL RIGHTS OF PURCHASE (ROFRS)

- What is a ROFR
 - at common law, is a contractual right capable of becoming an interest in land
 - Section 63 of *Law of Property Act* makes it an interest in land in Alberta

- Exceptions under CAPL
 - all or substantially all
 - 5% rule
 - corporate mergers, amalgamations and reorganizations
 - acquisition for shares

ROFRS CONT'D

- Always apply segregation when issuing ROFRs
- What about BPO/APO parties
- What about BPENN/APENN parties

ROFRS CONT'D

ISSUES

1. Valuation Disputes

- percent of total purchase price
- arbitration
- facilities vs. reserves

ROFRS CONT'D

2. Failure to Have Given Prior Notice

- “silent partners”
- *Limitations Act* application: Industry Agreement

ROFR CONT'D

4. Conflicting Agreements

- where agreements don't have "superseding" clauses

5. Non-CAPL

- where there is no segregation language and different owners of joint lands

6. Series of Transactions

- where exemptions may apply

ROFRS CONT'D

- Remedies for breach
 - Injunction (very very rare to get this)
 - specific performance (rare to get this)
 - damages

- Purchaser's knowledge of ROFR may create a limitation

- Likely must exercise and sue prior to expiry of ROFR period to support a claim

A&D

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Thank you.

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EnerLaw LLP is a Calgary based commercial law firm focusing primarily on the energy industry.

