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A Litigator's Perspective on the Purchase and Sale Agreement (PSA)

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Two lawyers from Gordon Arata's Lafayette office, Sam Masur and Paul Simon, spoke at the Institute for Energy Law's Inaugural Mergers and Acquisitions Conference in Houston, Texas.

Their topic was *A Litigator's Perspective on the Purchase and Sale Agreement (PSA)* The presentation provides a litigator's perspective on how agreements commonly used in oil and gas transactions—and the key provisions of those agreements—are viewed by litigators, courts, and juries and how transactional lawyers can help ensure those agreements and provisions are interpreted as they intend, and to their clients' advantage.

As the late great John McCollam said, "the first step in winning a lawsuit is convincing the judge to want to rule in your favor; every step thereafter—the gathering of the facts and evidence to support your position—is just giving him the vehicle to do so."

Agreements often are interpreted or applied years after the transaction they memorialized has concluded. Parties then often lack the background knowledge possessed by the persons who drafted them. The drawbacks from this situation can be lessened by considering the following six items:

1. **…the (future) audience:** Agreements are interpreted by judges and juries. Your task in drafting an agreement including crafting an agreement that a future judge or jury will want to enforce as you intend. This audience lacks background knowledge, and they also are people, not simply law-applying machines. Both of these factors dictate that an agreement is more likely to be enforced if it appeals to basic legal principles and principles of fairness. Concretely, this can be accomplished by adding background, explanations, and statements of party intent to the recitals and in potentially controversial provisions.
2. **…the "story": I**n the task of convincing a future audience to enforce a transaction as you intend, the written agreement obviously plays a unique role. It is the only document that is

certain to be studied by that audience. It also is objective, contemporaneous with the transaction, and expressly agreed to by the other parties against whom you could be litigating. Thus, its statements will carry far more weight than explanations presented for the first time at trial, and opposing parties will have a difficult time escaping what it says. Again, this goal can be harnessed by adding a narrative to the recitals (the first part of the agreement that will be read by a future judge or jury…) describing your version of the events that led to the transaction, and the parties' intent in entering into it. While many drafters neglect to do this because such narratives generally are not directly enforceable, in our experience, this context can make a tremendous difference with future judges and juries.

3. **…avoiding a lawsuit:** The easiest way to not lose a lawsuit is to avoid one altogether. Transactional lawyers typically consider this goal in the context of indemnities and arbitration clauses. In our experience, they less often consider how the substance of the agreement itself can accomplish this goal. This can be done, where possible, by treating counterparties fairly and giving aggrieved parties an out and/or a financial incentive not to pursue litigation. If a judge finds a clause unduly harsh or unfair with no reason explained in the agreement why the clause is there, that clause is less likely to be enforced. Similarly, if an agreement leaves an aggrieved party no option but to sue for something outrageous (and fact-intensive) like fraud, then outrageous suits are what may follow.
4. **…who will pay if a lawsuit occurs:** Skilled transactional attorneys almost reflexively make indemnities as strong as possible for their clients. But in our experience, an indemnity can be "too strong" if it is not drafted in light of a party's insurance coverage. Sometimes, it can be more beneficial for a party to leave open a claim against it covered by its insurance than to eliminate all insured claims and leave only claims for which the party will not have coverage (like fraud).
5. **…background law, rules, and precedent:** In reaction to judges seeming refusal (often for reasons of perceived inequity) to enforce provisions as written, many drafts react by writing more detailed provisions. But in our experience, this often is counterproductive. One reason is substantive: the more detailed a provision is, the less likely it is to be suited to unpredictable future situations. Arbitration agreements that dictate specific arbitration procedures are typical of this trend, as procedures designed with, for instance, the arbitration of a claim for payment of an open account in mind often will not be suited for a claim of a major accident and injury. The other reason is enforceability: greater detail throughout an agreement, especially on issues like dates and timetables, makes it more likely two provisions will contradict each other, giving rise to a finding of ambiguity and thus the inability to enforce those provisions on summary judgment. A more effective solution may be to be intimately familiar with, and utilize, the background law, rules, and precedent of your jurisdiction, including how specific provisions

have been enforced by courts in the past. Even if a provision seems vague, if another court has ruled on its meaning, the odds are high that a future court will follow that interpretation.

6. **…"standard" clauses:** The counterpart to the above is the array of "standard" clauses reflexively included in agreements, often because drafters are working from a prior agreement or template. These clauses often are unnecessary and can even work at cross-purposes with the actual intent of the agreement. For example, a "time is of the essence" clause is often included, even though the parties know that they may not close or complete post-closing procedures by the times specified in the agreement. Similarly, merger clauses are often included, even though the parties are executing other agreements at the same time (such as an asset purchase agreement with employment contracts) and desire these agreements be considered together. In both cases, including the "standard" clause can make these agreements ambiguous.

In conclusion, no drafter can have everyone's perspective or knowledge, but certain issues arise routinely in litigation because of choices drafters repeatedly make.These issues can be avoided if the parties drafting oil and gas purchase and sale agreements consider these topics in the drafting and negotiating process.

For more information on this topic, please see the full presentation here or contact Sam or Paul directly.