

# Preferential Rights to Purchase: The Basics, and The Most Interesting Pref Rights Case You've Never Heard About

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\*The views in this presentation are the author's and do not necessarily reflect the views of Apache Corporation or Fieldwood Energy LLC.

# Preferential Rights to Purchase: The Basics

- What in the world are Preferential Rights to Purchase?
- A PRP gives the holder of the right the option to purchase an asset on the same terms and conditions as offered by a Third Party.
- A PRP Holder can Trump the Third Party.



# Preferential Rights to Purchase: The Basics

- Why do we use Preferential Rights to Purchase?
  1. Increase Ownership Interests in Profitable Property
  2. Prevent Getting in Bed with Bad Business Partner

# Preferential Rights to Purchase: The Basics

- Preferential Rights to Purchase also are known as:
  1. Preferential Rights
  2. Preemptive Rights
  3. Rights of First Refusal (ROFRs)
  4. Contingent Rights

## But Don't Call Them Options! *Why not?*

- Not “Ripe” until Triggered by Offer from Third Party
- PRP Holder Can't Compel Sale
- Once PRP is Triggered, *Then* it Becomes an Option
- A Preferential Right is a “Dormant Option”

# Preferential Rights to Purchase: The Basics

- Where Do We Find PRPs?

1. Real Property Contracts

- a. Sales Contracts

- b. Lease Contracts

2. Franchise Agreements

3. Dealership Agreements

4. Partnership Agreements

5. Race Horse

6. Oil and Gas Contracts – Joint Operating Agreements



# Preferential Rights to Purchase: The Basics

## American Association of Professional Landmen Form 610 Operating Agreement (1989), Article VIII.F

Should any party desire to sell all or any part of its interest under this agreement, or its rights and interest in the Contract Area, it shall promptly give written notice to the other parties with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interest, or to transfer title to its interest to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interest, or to dispose of its interest by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interest to a subsidiary or parent company or to a subsidiary of a parent company or to any company in which such party owns a majority of the stock.

# Preferential Rights to Purchase: Pulling The Trigger



- When is a PRP Triggered?
  - Usually, When the Property Owner Receives a Bona Fide Offer from a Third Party.

*That's Pretty Simple and Straight Forward, right?*

# Preferential Rights to Purchase: Pulling The Trigger

- Two Questions:

1. What constitutes a “Bona Fide” Offer?
2. What Constitutes a “Triggering Event”?

Let's take the easy one first:



# Preferential Rights to Purchase: Pulling The Trigger

## 1. What Constitutes a “Bona Fide” Offer?

- a. Made in good faith
- b. Arms Length
- c. Precise – *i.e.*, not just vague conversation
- d. Buyer is ready, willing, and able to follow through

# Preferential Rights to Purchase: Pulling The Trigger

## 2. What Constitutes a “Triggering Event/Sale”?

- Gift? Consensus is “Not a Sale” because Seller receives no consideration.
- Involuntary Transfer – *e.g.*, bankruptcy? Consensus is “not a sale” because Seller did not intend to sell (not a voluntary sale) and Seller did not voluntarily accept offer from third party to buy.
- Sale from corporation to subsidiary? *Now it's getting interesting!*

# Preferential Rights to Purchase: Pulling The Trigger

## Is a Sale to a Subsidiary a Triggering Event?

*Let's Look at Model Form 610's Language:*

- “However, there shall be no preferential rights to purchase in those cases where any party wishes to ... dispose of its interests by merger, reorganization, consolidation, or sales of all or substantially all of its Oil and Gas assets to any party or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.” (AAPL 1989 Model Form 610)

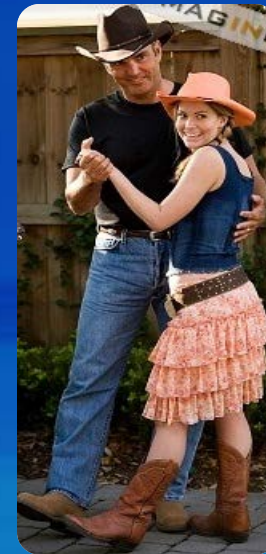
*What does that mean?*

If the property owner is selling the entire company (*i.e.*, a stock sale) or reorganizing under the corporate umbrella, PRPs are not triggered.

# Preferential Rights to Purchase: Pulling The Trigger

## The Texas Two-Step

*Scenario:* Property Owner wants to sell property(ies) to third party but both seller and third party want to avoid triggering the preferential rights. *Is there a way to do that?*



How about transferring the assets into a newly formed subsidiary (Step 1), and then selling the entire subsidiary to the third party (Step 2)?

In 1995, the first Appellate Court said “*Not so fast! Galveston Terminals, Inc. v. Tenneco Oil Co.*, 904 S.W.2d 787 (Tex. App – Houston [1st Dist.] 1995), *set aside without reference to the merits*, 922 S.W.2d 549 (Tex. 1996).

- Court said you should examine the substance of the transaction to determine the parties’ true intent and purpose.



# Preferential Rights to Purchase: Pulling The Trigger

## The Texas Two-Step (Cont.)

In 1996, the Texas Supreme Court Sanctioned the Texas Two-Step. *Tenneco Inc. v. Enterprise Prods. Co.*, 925 S.W.2d 640 (Tex. 1996)

- “We expressly disapprove of the court’s reasoning in *Galveston Terminals*.”
- “Sound corporate jurisprudence requires that courts narrowly construe rights of first refusal ....”
- “Viewing several separate transactions as a single transaction to invoke the right of first refusal compromises the law’s unfavorable estimation of such restrictive provisions.”

In that same year, Louisiana also blessed the Texas Two-Step. *Fina Oil & Chem. Co. v. Amoco Prod. Co.*, 673 So.2d 668 (La. Ct. App.), *writ denied*, 679 So.2d 1353 (La. 1996).



# Preferential Rights to Purchase: Pulling The Trigger

## The Texas Two-Step (cont.)

*But Beware:* Courts may look to ensure there is some legitimate business purpose behind the underlying transactions. Could raise red flag if transactions were done solely to circumvent preferential rights.



# Preferential Rights to Purchase: Giving Proper Notice

What constitutes proper notice to a holder of a PRP?

Read the PRP term in the JOA and follow it to the letter ... and be sure to check those pesky notice provisions at the end of the JOA.

AAPL Model Form 610 requires:

1. Name and address of prospective buyer
2. Purchase price
3. Legal description of the property
4. “and all other terms of the offer”
5. Deadline to exercise the PRP

*Best Rule of Thumb – Send PRP holder a copy of the PSA.*

# Preferential Rights to Purchase: Exercising a PRP

What do you do when you receive a PRP notice?

1. If incomplete, send written request for more information. Be specific ... *and be prompt!* And remember – a perfect notice from the property owner is not required.
2. If the notice is sufficient, run your economics and decide whether to exercise the PRP. *Don't delay!*



# Preferential Rights to Purchase: Exercising a PRP

## What Constitutes a Proper PRP Exercise?

1. Matches the terms and conditions of third party's offer *exactly*.
  - a. “Unqualified, absolute, unconditional, unequivocal, unambiguous, positive, without reservation.” *West Tex. Transmission, L.P. v. Enron Corp.*, 907 F.2d 1554, 1556 (5<sup>th</sup> Cir. 1990), *cert. denied*, 499 U.S. 906 (1991).
  - b. Some jurisdictions do not require PRP holder to match all nonmaterial terms.

# Preferential Rights to Purchase: Exercising a PRP

## 2. Timely received by Seller

- a. Key date is date received by Seller, not date sent.
- b. Ensure method of delivery complies with contract requirements.
  - *Check the notice provision at the end of contract!*



# Preferential Rights to Purchase: Exercising a PRP

*West Texas Transmission, L.P. v. Enron Corp.*, 907 F.2d 1554 (5<sup>th</sup> Cir. 1990), *cert. denied*, 499 U.S. 906 (1991).

The Wrench in the system!



Under *West Texas Transmission*, the PRP holder must match the existing offer's terms and conditions precisely, unless ...

1. The terms are not commercially reasonable, or
2. The terms are not imposed in good faith, or
3. The terms are specifically designed to defeat the PRP.

*So is this the current law in Texas?* 

# Preferential Rights to Purchase: Exercising a PRP

1. The 1<sup>st</sup> Appellate Court says “Yes”: *Texas State Optical, Inc. v. Wiggins*, 882 S.W.2d 8 (Tex. App.–Houston [1<sup>st</sup> Dist.] 1994, no writ)

Dissent: “I believe that the *West Texas Transmission* case did not follow Texas law; rather it created new law.”

2. The 2<sup>nd</sup> and 3<sup>rd</sup> Appellate Courts also have followed *West Texas Transmission*.
3. The 7<sup>th</sup> Appellate Court refused to do so: *Abraham Inv. Co. v. Payne Ranch, Inc.*, 968 S.W.2d 518, 527 (Tex. App.–Amarillo 1998, pet. denied) (C.J. Boyd).

“[T]he Fifth Circuit created these exceptions based in large part upon the law of other jurisdictions. Thus, rather than following these exceptions, we will directly follow Texas law.”



# Preferential Rights to Purchase: Exercising a PRP

Because of *West Texas Transmission* we now have uncertainty in PRP laws because we now have fact questions. This:

1. Gives PRP holder the ability to hijack deals;
2. Reduces marketability of properties that are burdened by PRPs;
3. Lowers value of properties that are burdened by PRPs.

# Preferential Rights to Purchase: Legal Games and Consequences

- What Legal Games can the Seller and the PRP Holder Play?
  1. Seller can argue PRP not triggered
  2. PRP holder can argue notice is deficient
    - Make continuing requests for additional information
    - Assert that clock doesn't start ticking until holder receives all requested information
  3. Seller can argue that exercise is invalid
    - Not timely
    - Does not precisely match terms and conditions
  4. In multi-property deals PRP holder can argue that value allocated to burdened property is too high
  5. PRP holder can argue *West Texas Transmission*:
    - Terms are not commercially reasonable
    - Terms are not imposed in good faith
    - Terms are specifically designed to circumvent PRP

Example: PSA requires Buyer to have S&P AAA rating



# Preferential Rights to Purchase: Tips

- Drafting Tips:

1. Avoid AAPL Model Form 610 language “should any party desire to sell ...” Too subjective. “Intend to sell” and “decide to sell” are not much better.

- One Suggestion:

“The selling party may not sell the burdened property to a party other than the party holding a preferential right to purchase the burdened property unless the party holding the preferential rights to purchase fails to exercise such right within 15 days of receiving written notice from the selling party of the potential sale of the burdened property.”



# Preferential Rights to Purchase: Tips

2. Specifically state what types of transfers do not trigger the PRP – *e.g.*, involuntary transfers, mergers, stock sales, transfers to affiliate, gifts ....
3. Specifically state how burdened property will be valued if included in large package sale – *e.g.*, Price = FMV as assessed by independent appraisal.
4. Specifically state which terms must be included in the PRP notice – *e.g.*, require that Seller include copy of Purchase & Sale Agreement.
5. Clearly state the deadline to exercise (*e.g.*, 15 days from date stated on notice) and that the exercise must be received by Seller by that deadline.

# Preferential Rights to Purchase: Additional Reading

- John R. Cooney, *Recent Developments Concerning Joint Operating Agreements– Preferential Rights and Exculpatory Clauses*, 55<sup>th</sup> Annual Program on Oil and Gas Law (Feb. 19-20, 2004).
- Terry I. Cross, *The Ties that Bind: Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties*, 5 TEX. WESLEYAN L. REV. 93 (1999); *see also* 2009 volume entitled *Consents and Preferential Rights*.
- Chris Kulander & Kirk Worley, *Navasota v. First Source Texas and Its Effect on Packaged Sales and Preferential Rights to Purchase Clauses*, 52 S. TEX. L. REV. 233 (2010).
- Fred R. Pletcher & Anthony A. Zoobkoff, *ROFR Madness! Rights of First Refusal in Mining and Oil & Gas Transaction*, 56<sup>TH</sup> ANNUAL ROCKY MTN. MIN. L. INST. (July 22, 2010).
- Robert J. Sergesketter, *Preferential Rights to Purchase: The Basics, and the Most Interesting Pref. Rights Case You've Never Heard About*, 5 HLRe (Houston Law Review Off the Record) 43 (2015).
- Rick Strange & Thomas Fahrung, *Rights of First Refusal and Package Oil and Gas Transactions*, 53 S. TEX. L. REV. 29 (2011).
- Robert K. Wise et al., *First - Refusal Rights Under Texas Law*, 62 BAYLOR L. REV. 433 (2010).

# The Battle for the Permian: Background



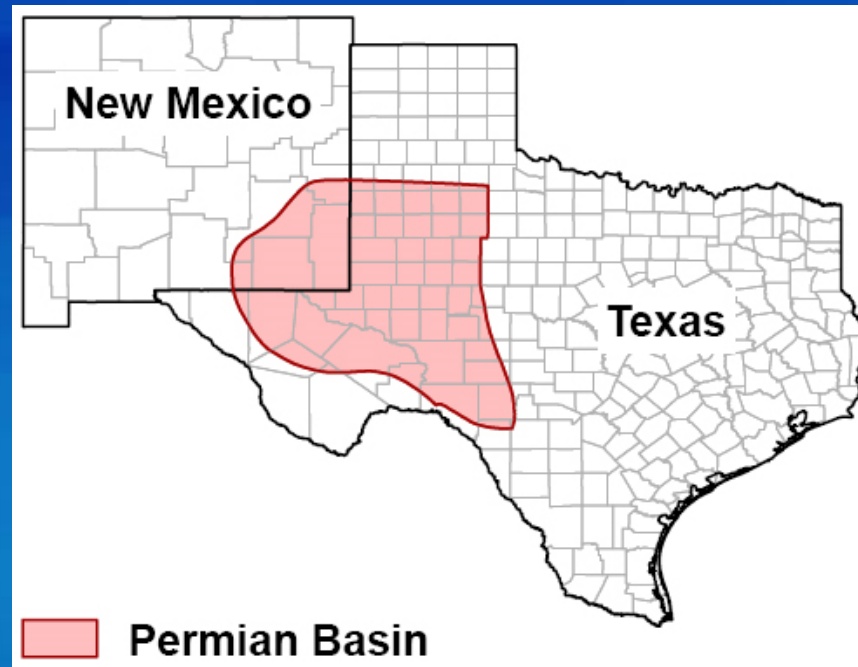


# The Battle for the Permian: Background

- BP was looking to sell properties in Egypt, Canada, and Permian Basin
- BP wanted an aggressive buyer that could sign and close a deal quickly
- BP's assets were a perfect fit with Apache's core areas; Apache had cash; and *Apache works fast!*

# The Battle for the Permian: Background

- BP and Marbob Energy Corp. own 50/50 undivided interests in certain Permian Properties



- Joint Operating Agreement gives each owner Pref Rights on those properties



# The Battle for the Permian: Dueling Deals

- July 20 – BP and Apache hours away from signing \$3B Purchase & Sale Agreement for Permian Properties
- July 20 – Moments before signing PSA, Marbob Energy Corp. and Concho Resources Inc. announce \$1.65B deal for Permian Properties
- Concho's deal could result in Apache losing nearly \$400mm in prime properties



*Stop The Presses!!!*

# The Battle for the Permian: Dueling Deals

## Apache's Options:

1. Proceed with BP deal and send Pref Right notices to Marbob
  - But what if Marbob exercises its pref rights and takes valuable properties?
2. Delay Signing PSA with BP until after BP exercises and closes on Pref Rights for Marbob's interest
  - But BP is ready to sign and close now!
3. Sign PSA and try to exercise Pref Rights on Marbob's 50% interest once BP receives Pref Right notices and before Marbob exercises on BP's notices.
4. Make a blind exercise on Marbob's 50% interest immediately—before executing PSA with BP *and before receiving Pref Right notices!*



# The Battle for the Permian: Apache Exercises PRPs

Which party needs to exercise Pref Rights—  
Apache or BP?

Answer: BP

# The Battle for the Permian: Marbob Fires The First Shot

## Marbob Files Suit

STATE OF NEW MEXICO  
COUNTY OF EDDY  
FIFTH JUDICIAL DISTRICT COURT

MARBOB ENERGY CORPORATION,  
PITCH ENERGY CORPORATION, and  
CONCHO RESOURCES INC.,  
Plaintiffs,

YATES PETROLEUM CORPORATION,  
DAVE BARRETT, SANDRA BARRETT,  
PREMIER OIL AND GAS, INC.,  
FEATHERSTONE DEVELOPMENT CORPORATION,  
MARATHON OIL COMPANY,  
CHASE OIL CORPORATION,  
KHODY LAND & MINERALS COMPANY, and  
MELROSE ENERGY COMPANY,  
Involuntary Plaintiffs,

vs.

BP AMERICA INC.,  
BP AMERICA PRODUCTION COMPANY,  
and ZPZ DELAWARE I LLC,  
Defendants.

**PLAINTIFFS' ORIGINAL COMPLAINT FOR  
DECLARATORY JUDGMENT AND INJUNCTIVE RELIEF**

TO THE HONORABLE JUDGE OF SAID COURT:

COME NOW MARBOB ENERGY CORPORATION ("Marbob"), Pitch Energy Corporation ("Pitch") and CONCHO RESOURCES INC. ("Concho"), Plaintiffs separately and on behalf of the Involuntary Plaintiffs, YATES PETROLEUM CORPORATION ("Yates"), DAVE AND SANDRA BARRETT ("the Barretts"), PREMIER OIL AND GAS, INC. ("Premier"), FEATHERSTONE DEVELOPMENT CORPORATION ("Featherstone"), MARATHON OIL COMPANY ("Marathon"), CHASE OIL CORPORATION ("Chase"), and KHODY LAND & MINERALS COMPANY ("Khody"), and MELROSE ENERGY COMPANY ("Melrose") in the above-entitled and numbered

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No. CV-10-648

THOMAS A. RUTLEDGE

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# The Battle for the Permian: Marbob Fires The First Shot

## Causes of Action:

### 1) Declaratory Judgment

- a. BP's Pref Right exercise is invalid
- b. Marbob has Pref Rights as to BP's 50% interest in the Permian Properties

### 2) Application for Temporary Injunction

- a. Require BP to send Pref Rights notices and additional information regarding the terms and conditions of the PSA
- b. Waive requirement for Marbob to make Performance Deposit



# The Battle for the Permian: Marbob Fires The First Shot

## Apache's Response to Marbob Lawsuit:

1. No irreparable harm
2. BP already sent Marbob proper and complete Pref Right notices

*But there's one catch with those notices—Marbob is not allowed to exercise its Pref Rights!*

- a. Under § 4.06 of the Marbob→Concho PSA the Permian Properties were “eliminated” from the deal as soon as BP exercised its Pref Rights on those properties.
- b. Under § 7.1 of the Marbob→Concho PSA, once the Permian Properties were “eliminated” from the deal, Marbob could take no action affecting the ownership in those properties without BP's Consent.
- c. BP refuses to consent to PRP exercise by Marbob.

# The Battle for the Permian: Marbob Fires The First Shot

Bottom Line : BP sent Marbob Pref Right notices on the Permian Properties, as required by the JOA, *but Marbob can't exercise on those notices.*

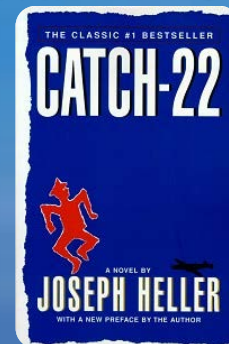
Let's Play Jeopardy!



Category: Famous American Novels for \$200

Answer: Joseph Heller's World War II novel about no-win situations

Question: What is Catch-22?



# The Battle for the Permian: Marbob Fires The First Shot

- Oh, and one more thing:



- Marbob's request to have the Court waive Marbob's requirement to make the 50% Performance Deposit is simply a back-door approach to allow Marbob to make an exercise that is not on the same terms and conditions as the BP→Apache PSA.

# The Battle for the Permian: Dueling Exercises/Key Questions

So Which Pref Right Exercises were Effective?

- 1) BP's?
- 2) Marbob's?

Questions to consider:

- Does the fact that the two underlying PSAs were signed just one day apart matter?
- What difference does it make that BP's exercise occurred before Marbob had even sent PRP notices?
- Does Marbob's failure to pay the Performance Deposit void its PRP exercise?

# The Battle for the Permian: Marbob Fires The First Shot

## 1. Request for Injunction Denied

STATE OF NEW MEXICO  
COUNTY OF EDDY  
FIFTH JUDICIAL DISTRICT

No. CV-10-647

MARBOB ENERGY CORPORATION, et al.,

Plaintiffs,

v.

BP AMERICA INC., et al.,

Defendants.

### ORDER DENYING MOTION FOR PRELIMINARY INJUNCTION

THIS MATTER having come before the Court on Plaintiffs' Motions in the Amended Complaints herein filed August 16, 2010 for the issuance of a Preliminary Injunction, and Defendants objection to venue raised in Response to the Motions, the Court having held an evidentiary hearing on August 20, 2010 and argument of counsel and being otherwise fully advised in the premises,

FINDS that Plaintiffs failed to prove that they will suffer irreparable harm in the absence of an injunction and that the legal remedy for damages is inadequate. The Court further FINDS that Plaintiffs may make any performance deposit required by depositing the funds with the registry of the Eddy County District Court Clerk.

The Court further FINDS that venue is proper in Eddy County New Mexico pursuant to NMSA 1978, §38-3-1(D) because the issues in the litigation involve ownership of real property located there, as well as, Joint Operating Agreements that provide that "this Agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non performance,



# The Battle for the Permian: Marbob Fires The First Shot

2. Request for waiver of Performance Deposit  
**Denied** – Marbob, roll the dice and live with the consequences.



# The Battle for the Permian: Dueling Exercises/Apache Goes On Offense

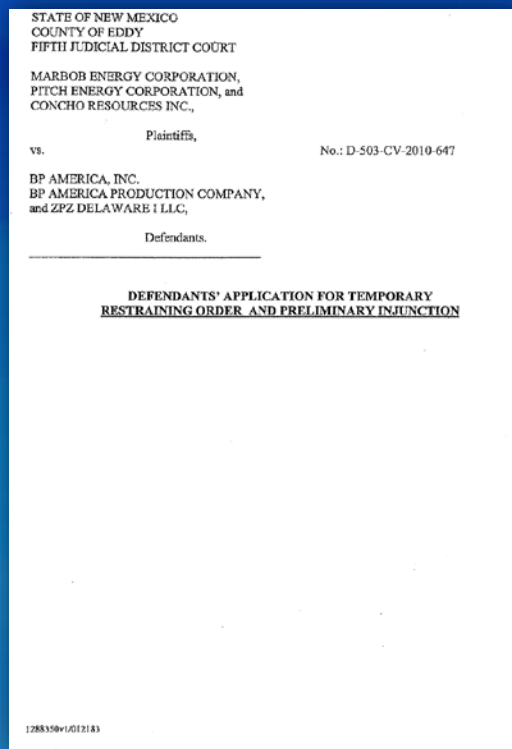


# The Battle for the Permian: Dueling Exercises/Apache Goes On Offense

- Pleading filed by Intervener stated that “the Marbob/Concho Agreement will close on October 1.”
- Marbob’s counsel refused to enter Rule 11 agreement not to close with Concho until after Court decides whether BP’s Pref Rights exercise was effective.

# The Battle for the Permian: Dueling Exercises/Apache Goes On Offense

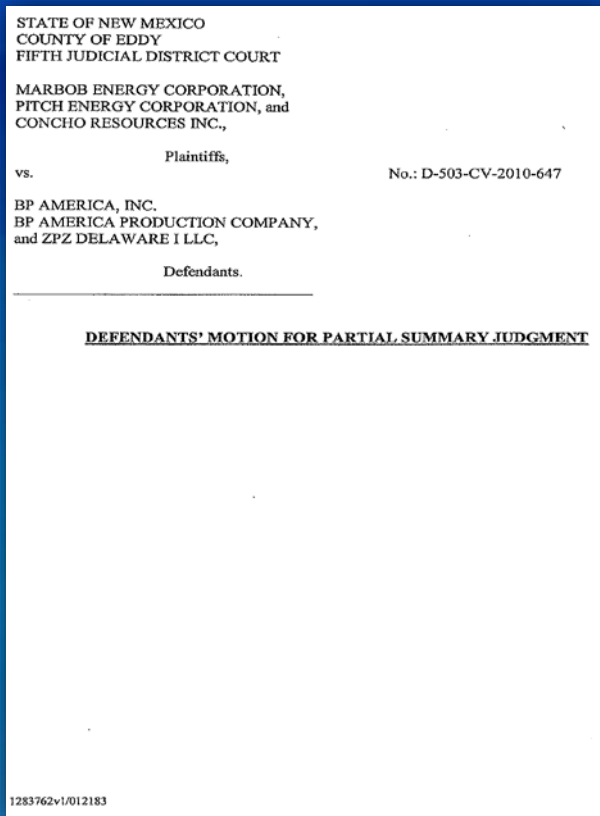
Apache files Application for TRO and Preliminary Injunction



- Maintain Status Quo (*i.e.*, don't allow Marbob to transfer its interest in the Permian Properties) until Court decides whether BP's exercise was effective.

# The Battle for the Permian: Dueling Exercises/Apache Goes On Offense

On same day, Apache filed an Expedited Motion for Partial Summary Judgment.



Prayer for Relief – Declare BP’s Pref Rights exercise valid and compel Marbob to transfer its 50% Interest in the Permian Properties to BP ASAP.



# The Battle for the Permian: Dueling Exercises/Apache Goes On Offense

And just to turn up the heat a bit more



Apache files Counterclaims against Marbob and Concho

- Breach of Contract by Marbob for failure to convey interest in Permian Properties to BP.
- Tortious interference by Concho for interfering with Marbob transferring its interests in the Permian Properties to BP.

# The Battle for the Permian: The Parties Make a Deal



- Marbob agrees to transfer a portion of its interest in the Permian Properties to BP
- Concho agrees to designate Apache as Operator for all Permian Properties

# The Battle for the Permian: The Final Twist

- Apache insisted that Marbob assign its interest in the Permian Properties directly to Apache, not to BP. And if Marbob refused, Apache would proceed with litigation rather than settle.
  - Why would Apache take this hard-line position?



# The Battle for the Permian: Have A Headache Yet?





# Preferential Rights to Purchase

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