THE ENERGY MERGERS & ACQUISITIONS REVIEW

Editors
Sean T Wheeler, Kristin Mendoza, Roald Nashi
and Robert S Fleishman

THE LAWREVIEWS

THE ENERGY MERGERS & ACQUISITIONS REVIEW

Editors
Sean T Wheeler, Kristin Mendoza, Roald Nashi
and Robert S Fleishman

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGER
Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Gavin Jordan

PRODUCTION AND OPERATIONS DIRECTOR
Adam Myers

PRODUCTION EDITOR
Anne Borthwick

SUBEDITOR
Janina Godowska

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-067-7

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ALLEN & GLEDHILL LLP

BIRD & BIRD

G ELIAS & CO

KIRKLAND & ELLIS LLP

PINHEIRO NETO ADVOGADOS

URÍA MENÉNDEZ – PROENÇA DE CARVALHO

CONTENTS

PREFACE.......... v
Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman

Chapter 1 BRAZIL.......... 1
José Roberto Oliva Júnior and Julia Batistella Machado

Chapter 2 HUNGARY.......... 8
Pál Szabó, Dániel Arányi and Eszter Gál

Chapter 3 NIGERIA.......... 22
Gbolahan Elias, Okechukwu J Okoro and Yemisi Falade

Chapter 4 PORTUGAL.......... 30
João Louro e Costa

Chapter 5 SINGAPORE.......... 40
Mark Quek, Yeo Boon Kiat, Aloysius Ng and Wong Jie Ning

Chapter 6 UNITED STATES.......... 50
Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman

Appendix 1 ABOUT THE AUTHORS.......... 71
Appendix 2 CONTRIBUTORS' CONTACT DETAILS.......... 77

PREFACE

Energy underpins our economy and is central for economic growth globally. Energy makes possible the investments, innovations and new industries that are the engines of jobs, growth and shared prosperity for entire economies. Although fossil fuels remain critical energy resources across the globe, the energy landscape is transforming, and renewable energy is playing an increasingly important role in helping countries develop modern, reliable and resilient energy systems, and address environmental and climate change concerns.

As the pre-eminent energy guru Dan Yergin has stated, 'innovation in the energy space is quite important'; 'innovation doesn't end; technological progress doesn't end'. The history of the energy industry is 'really the story of one innovation after another, starting with Colonel Drake in oil and Thomas Edison with the light bulb, to shale gas today'. And since Yergin said these things, innovation has indeed continued, as we have seen significant technological progress in electrical storage and smart energy networks.

Energy M&A is important in the facilitation of innovation, technological change, growth and access to resources in the energy industry. Effective energy M&A practitioners must address a broad range of legal and other issues that arise in all M&A transactions, as well as issues unique to the energy space. This volume puts down a marker in describing many key energy-related M&A issues. That is why this volume is important.

Kirkland & Ellis is a global law firm with over 250 lawyers involved in energy and infrastructure matters. We thought it was time for the firm to take a leadership role in working with *The Law Reviews* to launch this inaugural volume and serve as global editors.

We would like to thank all the lawyers at Kirkland who developed the US chapter. We would also like to thank the contributing authors from Brazil, Hungary, Nigeria, Portugal and Singapore for their efforts in helping to put together this inaugural volume.

We hope our readers will find this to be a useful resource as they navigate the changing landscape of energy M&A.

Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman
Kirkland & Ellis LLP
Houston, New York and Washington, DC
December 2019

Chapter 6

UNITED STATES

Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman[1]

I OVERVIEW

i Oil and gas

The oil and gas industry is composed of four separate but related sectors:

a upstream (companies engaged in the business of extracting hydrocarbons);
b midstream (companies engaged in the business of transporting hydrocarbons);
c services (companies engaged in the business of assisting upstream and midstream companies with the extraction and transportation of hydrocarbons); and
d downstream (companies engaged in the business of refining petroleum after extraction).

The oil and gas industry continued to see strong M&A activity through Q2 2019, but experienced a marked slowdown in Q3 2019 as the overall macroeconomic environment deteriorated and investor sentiment worsened due to:

a supply and demand concerns;
b geopolitical issues;
c the negative reaction to environmental, social and governance (ESG) issues at oil and gas companies;
d significant concerns around the amount and serviceability of indebtedness at many oil and gas companies; and
e expectations of reductions in upstream drilling budgets.

All of the above would in turn lead to reduced operational and financial growth generally for companies in the oil and gas industry.

The equity and debt capital markets have been closed for most oil and gas companies, with the exception of those companies with the best credit profile. Investors are looking for low levels of indebtedness, visibility to free cash flow generation and a return of capital through share repurchases or dividends, which many oil and gas companies cannot provide. Private equity companies have stepped in as an alternative source of financing through the use of innovative deal structures, including drillcos, wellbore securitisations and non-op joint ventures.

1 Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman are partners at Kirkland & Ellis LLP. The authors would like to thank the following lawyers at Kirkland who contributed to this report: Brooksany Barrowes, Devi Chandrasekaran, Scott Cockerham, Jonathan Fombonne, Nicholas Gladd, Christopher Heasley, Carla Hine, Ian John, Charles Harold Martin, Nick Niles, Anna Rotman, Ahmed Sidik, Chad Michael Smith, Paul Tanaka, David Wheat and Ali Abbas Zaidi.

ii Power and utilities

The power and utilities sector continued to see strong M&A activity through Q3 2019, but deal size has trended lower when compared to 2017 and 2018 levels.[2] Total deal value declined to just over U$5 billion in Q3 2019 for US power and utilities M&A, marking the quarter with the lowest value since the first half of 2017.[3] Asset deals have been the primary driver for M&A activity for power and utilities since 2018, which, when combined with lower deal value, signals a continued slowdown in consolidation in the sector generally since the most recent utility M&A wave in 2015 and 2016.[4]

While strategic deals dominated US power and utilities M&A both in terms of deal size and volume, private equity and other financial investors remained active across the sector.[5] In June 2019, for example, J P Morgan's Infrastructure Investments Fund announced the U$4.3 billion acquisition of El Paso Electric Company, the largest deal announced in the US power and utilities sector so far in 2019, although it would be eclipsed if the U$67 billion merger discussions between PPL and Avangrid reported in Q4 2019 were to materialise into a deal. The role of private equity and other financial investors in power and utilities M&A is expected to continue in the coming years, in large part due to capital deployment needs of infrastructure-focused funds, which have grown significantly in number and size. Private funds raised U$85 billion in capital for infrastructure investments globally in 2018, of which U$44 billion is attributable to North American-focused funds, and over 200 funds were seeking to raise in excess of U$190 billion of additional capital at the start of 2019.[6]

Renewable energy also continues to play an increasingly important role in the US power and utilities sector, driven by declining prices coupled with the improved performance of the underlying technology, as well as regulatory policies and investor commitments. Renewables have been driving a considerable amount of the M&A activity. In Q3 2019 alone, renewable deals represented more than 50 per cent of total deal volume and 19 per cent of total deal value in North America.[7] Policy shifts at all levels of the government and among investors in the US have – and will continue to have – meaningful impacts on renewable energy M&A activity, including the looming phase-down of US federal tax incentives and the advancement by state and local governments of renewable energy policies in the US as the federal government refrains from adopting formal climate change initiatives. In particular, 29 states and Washington, DC have adopted renewable portfolio standards, and California,

2 'North American power and utilities deals insights: Q3 2019', PwC, www.pwc.com/us/en/industries/power-utilities/library/quarterly-deals-insights.html.

3 Data and analytics provided by S&P Global Market Intelligence. Note that data excludes deals that have not been announced and deals for which a price has not been announced.

4 'North American power and utilities deals insights: Q3 2019', PwC, www.pwc.com/us/en/industries/power-utilities/library/quarterly-deals-insights.html.

5 'North American Power & Utilities Deals Insights – Q1 2019', PwC, www.pwc.com/ca/en/power-utilities/publications/576957-north-american-power-deals-insights-q1-2019.pdf; see also 'North American power and utilities deals insights: Q3 2019', PwC, www.pwc.com/us/en/industries/power-utilities/library/quarterly-deals-insights.html.

6 'Preqin 2018 Fundraising Update', Preqin Ltd, https://docs.preqin.com/reports/Preqin-Private-Capital-Fundraising-Update-Q4-2018.pdf; see also Alicia McElhaney, 'Preqin: Infrastructure Fund-raising Is on a Tear After a Record 2018', *Institutional Investor*, www.institutionalinvestor.com/article/b1clldtwk7b01k/Preqin-Infrastructure-Fundraising-Is-on-a-Tear-After-a-Record-2018.

7 'North American power and utilities deals insights: Q3 2019', PwC, www.pwc.com/us/en/industries/power-utilities/library/quarterly-deals-insights.html.

Hawaii, Maine, Nevada, New Mexico, New York, Washington and Washington, DC have all passed legislation committing to carbon-free electricity by certain dates. Investors in the US are also increasingly focused on acquiring or investing in renewable energy to meet their corporate zero-carbon or other ESG objectives. Socially responsible investments globally grew by 34 per cent to U$30.7 trillion over the past two years, and nearly half of S&P 500 companies addressed ESG topics in Q4 earnings calls in 2018.[8] Private equity firms are following this trend by creating dedicated impact investing product lines and platforms, including those specifically focused on renewables investing. Despite all of this M&A activity, the power and utilities sector continues to face an uncertain market in 2019, from state subsidies for certain generation resources and related changes to rules promulgated by the Federal Energy Regulatory Commission (FERC) and capacity market auctions in certain organised markets such as PJM and ISO New England, to price volatility in restructured power markets such as the Electric Reliability Council of Texas.

II YEAR IN REVIEW

i Oil and gas

Asset level M&A activity was relatively robust in Q1 and Q2 2019, but there was a marked slowdown during Q3 2019. Asset deals have been difficult to accomplish because of uncertain commodity prices and a disconnect between buyer and seller expectations, which are driven by different views on the level and trajectory of commodity prices in 2020 as well as potential regulatory constraints that could arise on the federal and state level. Federal concerns stem primarily from uncertainty surrounding the upcoming presidential election in November 2020 as several candidates have proposed a ban on the use of hydraulic fracking technology in the extraction of oil and natural gas. State concerns stem from similar issues around hydraulic fracking, and also from additional issues related to drilling setbacks and disposal wells.

In 2019, strategic deals – those involving public companies in the oil and gas industry – have been relatively robust, but investor reception has been decidedly mixed. Transactions where the consideration reflects a significant premium to the unaffected stock price prior to signing have been met with the severe scepticism of investors, while transactions where the consideration reflects no or a low premium to the unaffected stock price prior to signing have been met with investor applause. Shareholder activists have been quick to criticise numerous strategic deals, resulting in changes to the consideration to placate investors and achieve shareholder approval.

The largest strategic deal of 2019 was the August acquisition of Anadarko Petroleum Corp by Occidental Petroleum Corp for over U$55 billion in cash and stock, while smaller strategic deals also continued apace and included:

a Encana Corp's acquisition of Newfield Exploration Co (upstream) in an all-stock transaction;

b Ensco plc's acquisition of Rowan Companies plc (services) in an all-stock transaction;

c Callon Petroleum Corp's proposed acquisition of Carrizo Oil and Gas Inc in an all-stock transaction (upstream);

8 Emily Chasan, 'Global Sustainable Investments Rise 34 Percent to $30.7 Trillion', *Bloomberg*, 1 April 2019, www.bloomberg.com/news/articles/2019-04-01/global-sustainable-investments-rise-34-percent-to-30-7-trillion; Robert G Eccles and Svetlana Klimenko, 'The Investor Revolution', *Harvard Business Review*, May – June 2019 issue, https://hbr.org/2019/05/the-investor-revolution.

d Energy Transfer LP's proposed acquisition of SemGroup Corp in a cash and stock transaction (midstream);

e Parsley Energy, Inc's proposed acquisition of Jagged Peak Energy Inc in an all-stock transaction (upstream); and

f Keane Group, Inc's acquisition of C&J Energy Services, Inc in an all-stock transaction (services).

Private equity companies have also been fairly active in pursuing take-private transactions of oil and gas companies, the biggest of which was the acquisition of Buckeye Partners, LP by IFM Investors Pty Ltd for over U$6 billion in cash. There have been a number of additional take-private transactions involving companies with an equity market capitalisation of less than U$250 million.

ii Power and utilities

As noted previously, asset deals (spanning conventional and renewable generation, transmission, retail and storage assets) significantly contributed to M&A activity in the power and utilities space over the past year: Sempra's completion of its sale of operating wind and battery assets to American Electric Power for U$1.05 billion and Southern Power's agreement to sell its Mankato Energy Center to Xcel Energy-Minnesota for U$650 million are some of the more significant of these asset deals. Strategic buyers were most active in the power and utilities sector generally, and retail electricity assets emerged as noteworthy targets in 2019 as these buyers seek to grow market share and diversify revenue streams. A significant amount of this M&A activity took place in the Texas retail market where Vistra Energy announced deals to acquire both Ambit Energy Holdings, LLC, an electric retailer in Dallas, Texas, for U$475 million and Crius Energy Trust, owner of recognised Texas retail electricity brands such as TriEagle Energy, Energy Rewards and Viridian Energy, for over U$500 million. Lastly, a number of transactions, including CPPIB's U$2.63 billion announced take-private of Pattern Energy, KKR's U$900 million investment in NextEra Energy Partners to facilitate the acquisition of a renewables portfolio and Antin Infrastructure Partners' U$1.3 billion acquisition of Veolia Environment's district energy and cogeneration assets, demonstrate the continued broad interest of financial investors across asset classes in power and utilities M&A.

III LEGAL AND REGULATORY FRAMEWORK

As with M&A more broadly, the legal framework for energy M&A involves concurrent regulation under a variety of federal and state laws.

M&A in the energy industry (both oil and gas and power) are regulated at both the state and federal level. At the state level, approvals are typically required under applicable corporate laws where each entity to the transaction is organised and, in the case of certain portions of the power industry, approvals by local public utility commissions. At the federal level, strategic transactions receive the most scrutiny typically associated with the solicitation of votes from shareholders, the registration of shares being issued as consideration and the disclosures required for a fully informed vote by shareholders.

M&A in the energy industry are subject to antitrust laws. The US antitrust laws, primarily the Sherman Act and the Clayton Act, prohibit certain business conduct that harms consumers by reducing competition. Most relevantly, Section 7 of the Clayton Act prohibits M&A that are likely to substantially lessen competition. Section 7A of the Clayton Act, known as the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act), requires pre-closing notification of transactions meeting the jurisdictional thresholds to the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC). The HSR Act requires the parties seeking to undertake reportable transactions to submit filings to the DOJ and FTC and observe a waiting period prior to closing.

As in other sectors, the FTC and the DOJ take a fact-based approach to their assessment of mergers in energy markets, exemplified by their hands-off approach in exploration and production (E&P) and a more interventionist approach to downstream transactions. Going forward, the agencies' approach may also be impacted by broader political trends.

The energy regulatory frameworks applicable to energy M&A activities varies between upstream oil and gas E&P, midstream oil and gas infrastructure, and power assets.

Energy M&A activity involving upstream oil and gas exploration and midstream infrastructure is governed by a patchwork of state and federal laws and regulations. At the state level, the requirements vary by state, and are most often administered by a state's public utility commission, the state agency with jurisdiction over environmental matters, or both. For transactions involving upstream oil and gas E&P, the energy regulatory requirements generally are, in relative terms, not onerous. Those requirements typically involve the need to obtain approval from, or in some jurisdictions merely providing notice to, the relevant state regulatory body for the change in control or ownership of mineral leases, rights of way and other property interests involved in the transaction. If the transaction involves oil and gas exploration or production on federal lands, or in federal waters, there may be similar regulatory requirements at the federal level. Those federal requirements vary based on the type of federal lands or waters at issue (e.g., national parks, national forests, and waters of the Outer Continental Shelf) and the regulatory agency with jurisdiction over activities in such lands or waters.

Similarly, the legal framework for energy M&A activity involving midstream oil and gas infrastructure primarily consists of various state requirements. The states' respective regulatory requirements for energy M&A transactions range from minimal – for example, post-closing notification of a transaction – to significant – for example, requiring prior authorisation to consummate a transaction. Further, even among those states that require prior authorisation of such transactions, the timelines and standards of review used in those regulatory proceedings vary by state. At the federal level, there is no generic energy regulatory requirement applicable to energy M&A transactions involving midstream infrastructure. However, if a transaction involves changes to the physical or operational characteristics of, or the services provided by, a natural gas or oil pipeline that is regulated by FERC, those changes may require prior approval from FERC. Additionally, a change in ownership may require the filing of a post-closing notice at FERC, to the extent the change affects certain corporate information on file with the agency. Transactions involving the export or import of natural gas or oil can also trigger regulatory regimes administered by the US Department of Energy (DOE), the Marine Administration (MARAD) and the US Coast Guard (USCG), which may necessitate those agencies' prior authorisation of the transaction.

In contrast to the regulatory regimes for upstream and midstream oil and gas M&A transactions, the merger control regime for power (conventional and renewable) and utilities includes a robust federal regulatory programme. Depending on the specific assets involved in a transaction, prior authorisation for the transaction may need to be obtained from one or more regulatory agencies, including FERC, DOE, the Nuclear Regulatory Commission (NRC) and the Federal Communications Commission (FCC). Further, as with upstream and midstream oil and natural gas transactions, there is a patchwork of state legal and regulatory requirements applicable to energy M&A transactions involving power and utilities. Those requirements typically involve approval by the public utility commission or commissions in the states relevant to the transaction. At both the federal and state level, the regulators generally have the authority to impose conditions on a proposed transaction to ensure that the transaction is consistent with the public interest. It is not uncommon for regulators to exercise that authority, and the basis for doing so is most often to protect electricity consumers against potential, adverse rate impacts that could result from the transaction.

IV CROSS-BORDER TRANSACTIONS AND FOREIGN INVESTMENT

While M&A practitioners generally have long had to consider the implications of the Committee on Foreign Investment in the United States (CFIUS) in deals involving foreign investment, the impact of new proposed regulations implementing certain provisions of the Foreign Investment Risk Review Modernization Act of 2018 will be fully evident only after they are finalised and implemented. M&A participants are taking into account this heightened scrutiny, as it affects all aspects of deal-making from buy and sell-side due diligence to deal timing and closing certainty more generally.

V FINANCING

Since reaching record levels in 2018, US syndicating lending in the first half of 2019 was down by 33 per cent compared to the first half of 2018.[9] M&A leveraged loan issuances did not fare much better, with a similar decrease of 35 per cent measured across the same period.[10] In the energy space, there was a particular decreased deal count.[11] These trends may only continue with the largest banking lenders in the US oil and gas space marking down expectations for prices over the next five years.[12] Loan covenants in financings in the oil and gas space are also being tightened, according to a Dallas Federal Reserve Bank energy survey: the survey indicated some participants noted banks had lowered the maximum debt level permissible to two-and-a-half to three times earnings before interest, taxes, depreciation and amortisation from three-and-a-half to four times.[13] There will likely be more attention on

9 Practical Law Company, 'What's Market: 2019 Mid-Year Trends in Large Cap and Middle Market Loans', 18 July 2019, www.kirkland.com/-/media/publications/article/2019/07/whats-market_2019-mid_year-trends-in-large-cap-and/practical-law-finance-whats-market2019-midyear-tre.pdf.

10 id.

11 'Oil and Gas Activity Contracts as Uncertainty Remains Heightened', Dallas Fed Energy Survey, 25 September 2019, at 14, www.dallasfed.org/-/media/Documents/research/surveys/des/2019/1903/des1903.pdf.

12 David French and Jessica Resnick-Ault, 'Small U.S. oil and gas companies get cold shoulder from large banks', Reuters, 28 October 2019, www.reuters.com/article/us-usa-oil-lending/small-oil-and-gas-companies-get-cold-shoulder-from-large-banks-idUSKBN1X70BF.

13 'Oil and Gas Activity Contracts as Uncertainty Remains Heightened', Dallas Fed Energy Survey, 25 September 2019, at 14.

the financing of renewable projects, which require less equity and will follow a model more closely aligned with utilities in which power-purchase agreements with grids or end users offer relatively low but guaranteed returns sought by banks and pension funds.[14]

VI DUE DILIGENCE

i Overview

In connection with acquisitions of energy assets, there are various due diligence work streams that must be completed, including financial due diligence, operations due diligence and legal due diligence. Although these work streams often overlap and require interaction among various specialists, this chapter focuses on the requirements of legal due diligence. Under the rubric of legal due diligence, both in-house and outside legal counsel and other advisers analyse some or all of the target assets and applicable contracts to determine compliance with laws and regulations, legal title to the assets, required consents to consummate the transaction and compliance with other legal requirements (including contract terms).

Key components of the legal due diligence process for upstream transactions are reviewing title to oil and gas properties (whether in fee or in leasehold interests) and conducting appropriate environmental diligence, as described further in subsection ii. Asset-level M&A agreements typically contain defect provisions for both title and environmental diligence, where the purchase price can be adjusted for amounts related to defects in those areas. In addition to title and environmental diligence, it is also important to review drilling contracts (as they can carry multi-year commitments at significant cost), midstream contracts (including whether the upstream company is required to deliver minimum volumes to the midstream company) and saltwater disposal arrangements. Permitting and general regulatory diligence is also imperative.

A key component of the legal due diligence process for midstream transactions is reviewing key commercial agreements (such as gathering, processing, transportation and capacity agreements) associated with the assets. These agreements are particularly important to review given that they in large part determine the value of the midstream assets (and, in some instances, the associated upstream assets) and are generally long-term arrangements. Because so much of the asset value depends on the fees paid under these agreements, it is imperative that the purchaser carefully review the agreements prior to executing the acquisition agreement.

Unlike many other agreements in the oil and gas space, one initial point of emphasis when reviewing a gathering, processing or fractionation agreement is that there is no standard form. Indeed, midstream agreements are typically the subject of significant negotiation between the parties and are limited only by the collective imagination of the negotiating parties.

Key components of the legal due diligence process for power and utilities transactions are reviewing revenue-generating contracts (such as power purchase agreements), other key commercial and project agreements (such as interconnection agreements, engineering, procurement and construction agreements, operating and maintenance agreements, and

14 Dan Murtaugh and Sharon Cho, 'Big Oil's Renewable Shift Seen Flooding Investors With Cash', *Bloomberg*, 8 October 2019, www.bloomberg.com/news/articles/2019-10-08/big-oil-s-renewable-shift-seen-flooding-shareholders-with-cash.

hedging agreements), site documents (particularly for wind and commercial solar assets but also for conventional power assets) and permits, as well as conducting appropriate environmental diligence, as described further in subsection ii.

ii Environmental due diligence

Environmental due diligence for energy M&A transactions varies by market sector and segment, transaction type and the risk tolerance of the parties involved, and depends largely on the scope and timing of the due diligence process overall. A standard environmental due diligence review includes:

a submission of diligence requests;
b review of documents provided in a data room, securities filings (for public companies), and environmental permit transfer and change-of-control requirements (for asset transactions);
c searches of public environmental databases;
d interviews with company environmental personnel; and
e preparation of a due diligence summary or other work product.

In many instances, an environmental consultant is retained to conduct a technical environmental due diligence review. Depending on access to a company and the factors noted above, the technical review can include site visits (e.g., Phase I environmental site assessments) or consist solely of a desktop review.

Certain specific considerations for environmental due diligence in energy M&A are outlined below.

Oil and gas

Environmental due diligence in upstream oil and gas transactions traditionally involves a defect process, whereby access to the assets is granted for a period of time between signing and closing to identify environmental defects, which are then addressed pursuant to the negotiated terms of the agreement (e.g., the seller remediates the defect, the purchase price is reduced by the cost to remediate the defect or the asset impacted by the defect is excluded from the transaction). The buyer typically retains an environmental consultant with oil and gas expertise to visit all or a subset of assets during the review period to identify environmental defects. Such review is often limited by the agreement to visual inspections of the assets (i.e., no Phase II environmental site assessments or other subsurface sampling or testing). If the consultant identifies an environmental defect, the buyer or its counsel will work with the consultant to prepare a defect notice for submission to the seller. The parties will then negotiate a remedy to address the defect.

Power and utilities

M&A transactions in the power and utilities sector often involve complex environmental issues. Key focus areas for operating assets include allocation of emission credits, environmental obligations under consent decrees with regulators, environmental and toxic tort legacy liabilities, planned or anticipated capital expenditures (e.g., for pollution control equipment) and impacts of evolving environmental regulations. The environmental due diligence process typically follows the standard review described above, including retention of an environmental consultant. Key focus areas for development assets include environmental permitting, a National Environmental Policy Act (or state equivalent) review of projects on public lands, lender liability protections for environmental conditions at the project site, access to water supply and waste disposal services, and third-party project challenges to the project (such as appeals of issued environmental permits). Assistance of local counsel in the jurisdiction where the project is located is crucial. In most instances, rather than retaining its own consultants, the lender in any planned project financing will require and rely on independent engineer and environmental reports prepared by the borrower's consultants in connection with the financing.

ESG

Due, in part, to increasing interest in sustainable investment by investors, regulators and other stakeholders, more M&A practitioners are considering ESG factors, including climate-related risks, as part of their due diligence processes. Whether led by counsel or a third-party consultant, key components of managing an ESG due diligence review include understanding the drivers of the review, identifying the key ESG topics most likely to be material, developing an appropriate scope and work product, and integrating the review into other due diligence work streams.

VII PURCHASE AGREEMENTS AND DOCUMENTATION

Recent developments affect the way parties in the US conclude purchase agreements and draft documentation.

i Oil and gas

In the negotiation of a typical upstream oil and gas purchase and sale agreement (PSA), the title and environmental defect mechanics are among the most intensely negotiated provisions since the value being transferred is derived from the value of the oil and gas reserves (assuming no environmental contamination) and the reserves yet to be produced. While the variations of a title and environmental defect mechanic are virtually unlimited, and such provisions must take into account the negotiating posture, size and complexity of the deal, upstream counterparties have developed a market for defects that takes into account the seller's desire to complete the deal with minimal ongoing title liability and the purchaser's desire to have meaningful rights in the event that a title or environmental issue is identified and quantified.

A seller typically provides limited title and environmental documentation before the signing of a PSA. It is customary for most diligence to be conducted during the interim period; however, once the parties have moved into the interim period, the seller will be required to provide copies of all title documentation in its possession, including any previously commissioned title opinions and landmen run sheets, and provide access to the properties to conduct a customary Phase I review.

The purchaser's protections for title issues (other than a special warranty of title included in the assignment or deed) and environmental issues are typically limited to a defect process with notice provided to the seller a certain number of days prior to closing. Under this construct, the purchaser has the ability to access and verify title to the assets and the environmental status of the assets during the period between the signing and closing of the PSA. Subject to agreed limitations, including specified thresholds and deductibles, the purchaser is entitled to a downward purchase price adjustment for identified defects affecting the assets. Once the defect claim period expires, the seller typically provides no ongoing warranties related to title or environmental issues (other than the special warranty of title).

Outside of the title and environmental construct identified above, PSAs typically include a suite of non-fundamental representations and warranties related to the status of the assets. A seller's representations 'package' is usually heavily negotiated, including exceptions and limitations on the representations, knowledge qualifiers and survival. Typical representations include:

a pending or threatened litigation;
b unwaived third-party rights;
c material contracts;
d outstanding authorisation for expenditure commitments;
e wells and equipment;
f known title and environmental issues;
g taxes;
h correct payment of royalties;
i suspense amounts or imbalance;
j compliance with laws;
k accuracy of lease operating statements; and
l no material adverse effects (MAEs).

A buyer will typically have the right to terminate a PSA in the event the seller materially breaches a representation or warranty as of the closing, but the actual 'bring down' standard is often heavily negotiated (e.g., MAE, material breach, etc.). In addition, to the extent the representations survive the closing, a breach may give rise to a cause of action for damages.

In addition to asset-level representations and warranties, a PSA typically provides for indemnity for certain retained obligations, which unlike representations and warranties is not typically subject to thresholds, deductibles and caps. Although the scope of retained obligations is heavily negotiated, in most recent deals, buyers are able to require that a seller retain liabilities associated with known environmental matters and offsite waste disposal, mispayment of royalties prior to the effective time, specified litigation, taxes and excluded assets.

ii Power and utilities

Understanding the regulatory landscape

Regulatory considerations under the HSR Act are relevant to acquisitions and divestures in the power and utilities sector depending on the nature and size of the transaction and the identity of the buyer much like they are in other, non-energy M&A transaction. However, the nature of power and utilities assets poses additional regulatory complexities which are critical to assessing deal execution risk and closing certainty.

Due to the regulated natured of power and utility assets, additional regulatory approvals from FERC and state public utility commissions can impose conditions and commitments on prospective owners of these assets. The level of effort required of parties to obtain these additional regulatory approvals (and the limitations on such effort) and the consequences for the termination of transactions due to a failure to obtain these regulatory approvals can vary greatly across transactions. To mitigate the risk of regulatory failures, M&A purchase agreements will often include a broader scope of representations and warranties covering regulatory matters, such as the regulatory status of the seller and target and the absence of any regulatory impediments with respect to the buyer's ability to consummate a transaction, specific interim covenants relating to actions that would prevent or materially delay the ability of the parties to obtain regulatory approvals, and termination fees tied to failures to obtain necessary regulatory approvals.

Risk of loss and casualty and condemnation provisions

Much like industry-agnostic M&A agreements, enhanced closing certainty is a key consideration for parties in power and utility transactions, but to preserve value buyers will oftentimes seek risk of loss and casualty and condemnation provisions in their transactions: these continue to be heavily negotiated as they diminish closing certainty for sellers. Risk of loss and casualty and condemnation provisions allocate the risk of loss to operating facilities as between the seller and the buyer during the interim period of a transaction: they generally seek to protect the buyer from loss of the value derived from uninterrupted operation of target facilities. While these provisions can take a variety of forms, they generally provide a remedy for buyers in the event of a casualty or condemnation event resulting in some pre-agreed amount of damage to or loss in value of the target facilities, and a termination right allowing either the buyer or the seller to terminate the transaction should such damage or loss in value exceed a material percentage that would likely fall short of constituting a material adverse effect as construed in Delaware.

Value considerations

Both sellers and buyers in all M&A purchase agreements will seek to include provisions to maximise and preserve value in their transactions: the most common provisions tend to relate to purchase price adjustment mechanics or the covenants that bind the seller during the interim period.

In power and utilities M&A transactions involving private targets, sellers will often include purchase price adjustments for items that are specific to power and utility assets such as capital expenditures, spare parts and fuel inventory, which complement the more generic adjustments for working capital, indebtedness and cash. Buyers will seek to either eliminate these additional adjustments or limit their applicability by negotiating target amounts or introducing caps.

Additionally, power and utilities buyers have been increasing their use of 'modified' locked box constructs to adjust the purchase price in their M&A agreements. A traditional locked box purchase price adjustment fixes the price at the time of execution of the acquisition agreement based on historical (usually the last audited) balance sheet accounts: the buyer, therefore, takes on the economic risks and benefits of the target during the period between signing and closing of the transaction. In a modified locked box construct, these same principles apply, but the price is instead fixed at some later-agreed date, typically representative of the valuation date underlying the buyer's model of the target, and which may follow the execution date of the acquisition agreement. Buyers are increasing their use of modified locked box constructs to ensure an alignment of purchase price and their modelling assumptions, including assumptions regarding seasonal outputs, upcoming major maintenance and other similar external factors.

Buyers will similarly attempt to maintain value in power and utility M&A transactions by imposing additional tailored covenants on sellers during the interim period. Examples of these interim period covenants include requiring the seller to spend capital expenditures in accordance with an interim period budget (if ultimately agreeable, the seller will want to ensure that this aligns with a budget it previously represented during diligence) and implementing a specific hedging programme designed to secure the economic assumptions on which the buyer based its financial model prior to actually owning the target assets. Deal teams should involve HSR counsel in drafting specific language for these provisions to ensure that the parties do not run afoul of gun jumping rules; there is less risk of gun jumping the more the covenants are consistent with the seller's historic ordinary course of operations of the target assets.

iii Representation and warranty insurance to reduce transaction risk

Dealmakers in the power and utilities and oil and gas sectors are keen to reduce transaction risk as much as industry-agnostic dealmakers, and are increasingly availing themselves of a trend that has become more prevalent in M&A agreements generally across all industries and sectors in recent years: representation and warranty insurance (RWI). As described in more detail in Section IX, more M&A practitioners in the power and utilities and oil and gas sectors are turning to RWI and no indemnity deals (where the seller has no post-closing recourse for breaches of representations or warranties) to help eliminate transaction risk.

VIII KEY REGULATORY ISSUES

i Competition

As described above, M&A in the energy industry are subject to antitrust laws. The HSR Act requires the parties seeking to undertake reportable transactions to submit filings to the DOJ and FTC and observe a waiting period prior to closing. During that waiting period, the DOJ and FTC assess the likely competitive effects of a deal prophylactically, avoiding the difficulties associated with trying to 'unscramble the eggs' post-closing to restore previous levels of competition. Under the HSR Act, parties must notify the DOJ and FTC of an acquisition of voting securities, assets, or a controlling interest in a non-corporate entity if the size of transaction is US$200 million (as adjusted, currently US$359.9 million), or US$50 million (as adjusted, currently US$90 million) if the parties also meet certain size of person thresholds. These thresholds are adjusted annually for the increase or decrease in gross national product in the prior fiscal year. Certain exemptions apply to the acquisition of some types of carbon-based mineral reserves. For example, the acquisition of reserves or rights to reserves of oil, natural gas, shale or tar sands, and reserves or rights to reserves of coal and associated exploration or production assets are exempt provided they are not valued in excess of certain thresholds. These exemptions apply to upstream assets, but not midstream or downstream assets, or industry-related services.

To determine whether a potential transaction is likely to harm competition, the agencies analyse a host of industry-specific factors. They start by seeking to define relevant product and geographic markets, identifying market participants, and then attempt to determine how a proposed transaction likely would affect competition in each market by assessing the closeness of competition between the merging firms, the competition provided by remaining rivals, the efficiencies the deal is likely to generate and the potential for entry by new competitors, among other factors. If their investigation concludes that a deal is likely to be anticompetitive (i.e., likely to raise prices or restrict output in a way that is likely to harm consumers), the agencies may seek to enter into a negotiated settlement with the parties to remedy the perceived potential for harm (e.g., agreed divestitures) or attempt to a block the deal by seeking an injunction in federal court. Historically, the FTC has reviewed coal transactions and deals in the midstream and downstream sectors of the petroleum industry, while the DOJ has focused on electric power transactions and deals in the petroleum industry involving the upstream sector and oilfield services.

In recent years, the DOJ has not challenged transactions involving E&P companies. The agencies appear to understand that the upstream marketplace is highly fragmented because there are myriad producers in the United Stated and worldwide. On the other hand, the DOJ has been more active with respect to oilfield services companies adjacent to the E&P firms. In 2016, Halliburton and Baker Hughes abandoned their US$34 billion merger shortly after the DOJ sued, seeking a federal court injunction to block it. The agency alleged that the deal would have eliminated competition between two of the three largest oilfield services companies in 23 different service markets. In the midstream and downstream sectors, the FTC has recently required divestitures when it believed that deals would harm competition in certain local regions, leaving customers with limited or no economical alternatives. For example, in 2016 the FTC obtained concessions from the parties in connection with the merger between Energy Transfer Equity and the Williams Companies, which were at the time two of the three top gas pipeline operators in Florida. Specifically, the parties agreed to divest Williams Companies' interest in a major pipeline to an approved buyer to maintain competition in the area. Similarly, to resolve FTC concerns regarding its proposed 2018 acquisition of CrossAmerica Partners, Alimentation Couche-Tard agreed to sell gas stations in 10 local areas where the proposed transaction would have reduced the number of independent sellers from four to three, three to two or two to one.

ii Environmental protection

At the federal level, the trend in recent years has been to roll back environmental regulations governing the energy industry. Over the course of 2018 and early 2019, President Trump's administration has continued its efforts to unwind the Obama-era Climate Action Plan and has taken significant steps toward implementing the changes announced in President Trump's Executive Order 13783, which was aimed at eliminating regulatory requirements on domestic energy development. For example, the US Environmental Protection Agency has proposed or implemented rollbacks of federal regulations regarding methane emissions from upstream oil and gas sources, hydraulic fracturing on public lands, and carbon dioxide emissions and coal ash waste from coal-fired power plants. However, at the state level, certain states have taken up the mantle of increasing protection of the environment against energy industry impacts and taking proactive action to address climate change. Most notably on oil and gas production, Colorado Senate Bill 19-181, which was signed into law 16 April 2019, expands local government control over oil and gas development in the state, elevates environmental, health and safety considerations in permitting decisions, and alters pooling, drilling and permitting requirements to be less favourable to industry. The past year has also seen expansion of greenhouse gas 'cap and trade', with states including New Jersey, Pennsylvania and Virginia taking steps to join a regional initiative to reduce greenhouse gas emissions. In addition to state action, recent court decisions have trended towards requiring federal agencies to consider climate-related risks when reviewing energy projects (e.g., interstate pipelines, oil and gas leases on public lands, electric transmission lines) under the National Environmental Policy Act.

iii Health & Safety

On the health and safety front, under a new Occupational Safety and Health Administration standard limiting respirable silica exposure that went into effect on 23 June 2018, the oil and gas industry must implement engineering controls and work practices to limit exposures below the new limits by 23 June 2021.

iv Tax

Oil and gas M&A transactions raise many of the same tax issues that arise in M&A in other industries. For example, tax-free, like-kind exchanges are prevalent in oil and gas transactions. Of course, there are tax issues unique to the oil and gas industry. Many of these issues relate to certain favourable oil and gas tax rules, such as the ability to take depletion deductions with respect to oil and gas properties and to deduct drilling costs in the year incurred. Oil and gas tax is a highly specialised area requiring a knowledge of both the tax rules and the industry.

The biggest tax development in recent years was the passage of the landmark Tax Cuts and Jobs Act (TCJA) in 2017. The TCJA has impacted M&A transactions, primarily through the enactment of 100 per cent expensing (bonus depreciation) for certain tangible assets. These new expensing rules apply to acquisitions of most midstream assets but have limited applicability to acquisitions of upstream oil and gas properties. The rules apply to most renewable energy assets as well, such as solar and wind assets. Used equipment is also eligible for bonus depreciation if it is acquired from an unrelated party in an arm's-length sale. Bonus depreciation is available at a 100 per cent level for qualifying tangible assets placed in service until December 2022. It then phases down by 20 per cent per year for property placed in service until 2026. Certain longer-lived tangible assets that are normally depreciated over 10 or more years, such as transmission lines, are allowed an additional year to qualify (subject to certain limitations). The TCJA also limits interest deductibility and the use of net operating loss carry forwards.

In addition, the TCJA cut the corporate tax rate from 35 to 21 per cent. This development, along with others (including a key FERC ruling), has led certain publicly traded master limited partnerships to abandon their pass-through status and convert to corporations.

v Anti-money laundering and anti-corruption

Recent focus in this space continues to be a dynamic US sanctions landscape. US sanctions have had arguably a unique impact on the energy sector given the prevalence of state-owned energy companies in countries that have found themselves in the crosshairs of US foreign policy. For instance, the US has shown few signs of relaxing its sectoral sanctions programme targeting a number of Russian state-owned oil and gas companies. These sanctions broadly prohibit US persons from trading in certain new equity and moderate-to-long-term debt instruments of a number of Russian energy firms and their subsidiaries.

Further, US sanctions against Venezuela and its state-owned enterprises have had a significant impact on the ability of its energy sector to access financial markets. One significant collateral consequence of these comprehensive sanctions against Venezuelan state entities has been to prompt US-based Citgo to cut ties from Petróleos de Venezuela, its corporate parent, in exchange for relief from US sanctions. For the time being, Citgo nominally remains a sanctioned entity, albeit subject to a general licence to permit its continued access to US counterparties and global financial markets. More recently, in late September 2019, as part of its continuing imposition of sanctions with respect to Iran, the United States targeted with comprehensive sanctions a number of Chinese tanker vessels known to have transported Iranian oil products, opening yet another dimension of risk facing energy companies globally.

The existence and complexity of US sanctions underscores the importance of a robust anti-money laundering process that entails thorough know your customer diligence of transaction counterparties, as well as key contractual counterparties of acquisition targets, to identify both extant risk as well as exposure to escalating sanctions on a going-forward basis. Companies entering joint ventures and service contracts are well advised to incorporate termination provisions tied to the imposition of US sanctions as a supplement to force majeure clauses.

Inherent corruption risk remains prevalent in the energy sector in much of the world. Operational complexity, the high-stakes nature of energy and natural resources exploration grants and contracts, and the prevalence of state-owned entities and regulatory hurdles in emerging markets that inherently present a higher risk of corruption are some reasons for the increased corruption risk in this sector. While anti-corruption enforcement in this sector is hardly novel, what bears notice is the prevalence of non-US anti-corruption enforcement in recent years. Multinational cooperation with respect to anti-corruption enforcement activity in the energy sector in Brazil, Mexico, Ecuador, Venezuela and Argentina, among other jurisdictions, underscores the dual-front nature of this risk.

vi Energy regulation

Among the most important regulatory issues in energy M&A transactions are the various prior authorisations necessary to consummate a transaction. As noted above, states take various approaches to regulating such transactions, with only some states requiring prior regulatory approval of the transaction. At the federal level, however, there are multiple regulatory agencies with authorisation requirements that could be triggered by an energy M&A transaction; those agencies include FERC, the DOE, the NRC, MARAD and USCG, and the FCC. Accordingly, for any energy M&A transaction, detailed knowledge of the assets, and the regulatory permits and licences they hold or require, is critical to avoid closing over one or more of the necessary prior authorisation requirements that may apply.

In recent years, one of the most significant developments in the US energy sector is the increased export of natural gas, particularly as liquefied natural gas (LNG). FERC and the DOE share jurisdiction over the export and import of natural gas and LNG, with the DOE having authority over the actual import and export of the commodity and FERC having authority over the facilities used for such imports and exports. Although FERC's regulatory regime is commercially relevant to energy M&A transactions involving such infrastructure, FERC's prior approval is not necessary for such transactions, absent a change in the operations or services provided by the facilities. The DOE, however, does have rules pertaining to changes in ownership or control of facilities used for natural gas and LNG exports and imports. Depending on the nature of the transaction and whether it constitutes a change in control for the DOE's purposes, DOE approval may be required. If approval is required, the specific process for obtaining it varies depending on the terms of the individual export authorisation at issue and whether the nation to which the exports are shipped has entered into a free trade agreement with the United States. If an onshore or offshore oil or natural gas asset qualifies as a deepwater port, under the Deepwater Ports Act of 1974, it is also subject to an additional regulatory regime that is jointly administered by MARAD and USCG, in conjunction with numerous other federal and state agencies. Given the extensive nature of the overlapping federal and state regulatory regimes for deepwater ports, energy M&A transactions that involve deepwater port facilities may require multiple regulatory authorisations, including a prior authorisation from MARAD if a deepwater port licence includes a condition requiring such authorisation prior to a change in ownership.

The federal regulatory requirements most often relevant to transactions involving power and utilities are those administered by FERC, pursuant to Section 203 of the Federal Power Act, which requires public utilities to obtain FERC's prior authorisation for certain types of transactions. As relevant to energy M&A, that statutory provision requires prior approval from FERC before a public utility:

a sells, leases or otherwise disposes of a FERC-jurisdictional transmission facility, or any part thereof, in excess of US$10 million;

b directly or indirectly merge or consolidate FERC-jurisdictional transmission facilities, or any part thereof, that have a value in excess of US$10 million, with the facilities of any other person; or

c purchase, lease, or otherwise acquire an existing generation facility that has a value in excess of US$10 million and is used for interstate wholesale sales over which FERC has rate-making jurisdiction.

In addition to the FERC requirements, energy M&A transactions can also necessitate prior authorisation from other federal agencies for the transfer of certain permits or licences. For example, M&A transactions involving radioactive materials implicate federal regulatory requirements administered by the Nuclear Regulatory Commission (NRC). In particular, under Section 184 of the Atomic Energy Act and the NRC's implementing regulations, the licence for a nuclear generation facility, and any right under such a licence, may not be 'transferred, assigned, or in any manner disposed of, voluntarily or involuntarily, directly or indirectly, through transfer of control of the license to any person, unless the [NRC] gives its consent in writing'. That prior authorisation requirement applies to nuclear reactors, which may be included in a power sector M&A transaction, and the various devices and instruments containing radioactive material that are often used in upstream and midstream natural gas and oil operations.

Finally, any given energy M&A transaction, whether for upstream or midstream oil and natural gas assets or for power assets, may induce regulatory requirements, including prior authorisation requirements of the FCC. Companies in the oil, natural gas and power industries commonly use communications systems that are regulated by, and require licences from, the FCC. The FCC regulates changes in control of such licences, with the specific requirements varying based on the type of licence at issue. Some licences may be transferred with the FCC's prior approval, whereas other licences require the acquiring entity to apply for a new licence prior to a change in control.

The various energy regulatory regimes and prior authorisations discussed above follow different procedural rules and timelines, many of which are measured in months rather than days or weeks. It is imperative that the energy regulatory requirements associated with an energy M&A transaction be identified and built into a deal timeline in the early stages of a transaction.

IX INSURANCE

More energy M&A practitioners are turning to RWI and no indemnity deals (where the seller has no post-closing recourse for breaches of representations or warranties) to help eliminate transaction risk. Aon, a leading provider of representation and warranty products, estimates that over 45 per cent of private M&A transactions in North America utilise RWI in their transactions, up from 34 per cent in 2017, with 25 per cent of the transactions in 2018 structured as no indemnity deals.[15]

RWI is becoming more prevalent in energy transactions as the cost of policies continues to decline and broader coverage terms, particularly with respect to tax matters, offer more comprehensive coverage for buyers. RWI providers are also becoming more sophisticated in their approach to underwriting environmental risk, although for industrial targets, such as those in the energy space, many providers will cover contamination-related risks only in excess of an underlying pollution legal liability (PLL) insurance policy. While several European insurers have recently implemented restrictions on underwriting in the coal industry, PLL coverage, including coverage for existing contamination, continues to be available for coal industry targets from certain US carriers. Pairing a PLL policy with a RWI policy can facilitate no indemnity deals even for the types of complex environmental risks often attendant in the energy space.

X DISPUTE RESOLUTION

Energy deals are susceptible to the same type of litigation seen in M&A transactions across all industries. Litigation following an M&A transaction is frequent, and almost inevitable in the case of mergers involving publicly traded companies. While litigation is common, there are several measures M&A parties can take to mitigate risk and avoid inefficient and protracted litigation. Below is a description of some of the most frequent types of M&A-related claims and causes of action, and some of the provisions in merger agreements that can have a significant impact on merger-related litigation.

Common merger-related litigation

Disclosure 'strike suits' and other shareholder suits

M&A are often subject to lawsuits raised by (usually the seller's) shareholders. This is especially prevalent with publicly traded companies. A typical form of shareholder lawsuit is a strike suit seeking an injunction of the merger in order to leverage a potential delay of the transaction and extract a settlement. Most often, these are premised on the seller having allegedly improper public disclosures regarding the transaction and the seller agreeing to settle to allow the transaction to go forward. In recent years, however, Delaware courts have refused to approve such settlements because they provide little value to shareholders, although strike suits continue to be filed in other state and federal courts. Although these suits are unavoidable, thorough disclosures can mitigate liability. Engaging a disclosure expert who can fashion disclosures that are sufficient and on par with those of the company's peers can help lower settlement value.

15 'North America M&A and Transaction Solutions - Risk in Review 2019', Mergermarket and Aon plc, www.mergermarket.com/assets/Aon_Q1%202019_Final_LR%20(updated)_0.pdf.

In certain jurisdictions providing for dissenting shareholders' rights, appraisal suits are filed by the target's shareholders dissatisfied with the consideration for their stock seeking to recover a premium over the purchase price. The court will determine the fair value of the shares, exclusive of any increase captured by the expectation of the merger. While deal price is sometimes considered the best evidence of fair value, courts will also consider evidence related to the merger process, including whether the transaction was arm's-length. Building a strong record during the negotiations and diligence, including minutes of board meetings, showing that the parties to the transaction bargained at arm's-length, and that the transaction was approved by disinterested directors and by a fully informed stockholder vote, can go a long way towards defeating appraisal actions.

MAE clause

Most merger agreements have a MAE clause, which allows a buyer to terminate a purchase when there has been a change (typically between execution and closing) in the target's business that is so significant as to essentially defeat the entire purpose of the transaction. While it has historically been extremely difficult for buyers to invoke MAE clauses, a recent decision in Delaware Chancery Court shows that courts are willing to enforce MAE clauses where the facts are egregious enough that the entire transaction should be set aside.[16]

M&A practitioners should, therefore, engage in careful drafting of MAE clauses so that they properly capture the risks their clients are willing to take.

Earnouts

An earnout provides a seller with additional consideration based on the performance of a business or asset following the close of a transaction. While earnout provisions help parties who cannot agree on a final transaction price, they can be the subject of litigation if the earnout provision is not drafted carefully. In a recent Delaware case, the Chancery Court found that a buyer's attempt to withhold earnout payments based on suspected fraud by the acquired company's CEO did not comply with the mechanism of the earnout provision, which required payment of the earnout to the seller once the buyer had identified the amount of the earnout.[17]

While the earnout provision did permit the seller to challenge the earnout and for a third-party auditor to determine the result of such a challenge, the buyer had the burden of checking its earnout numbers for any adjustments based on fraud. Parties to M&A transactions should, therefore, draft earnout provisions and their dispute resolution procedures carefully to protect their clients' respective interests in the event of a dispute.

Key terms and conditions impacting merger litigation

Governing law and forum selection clauses

Of the deal terms that can impact M&A parties' chances in litigation, clauses on governing law and forum selection rank near the top. Governing law clauses are an agreement by the parties to a merger agreement that any dispute related to the terms of that agreement will governed by the law of a specific jurisdiction. Certain jurisdictions, such as Delaware

16 *Akorn, Inc v. Fresenius KABI AG*, 198 A3d 724 (Del 2018).

17 *GreenStar IH Rep, LLC v. Tutor Perini Corp*, CA No. 12885–VCS, 2017 WL 5035567 (Del Ch, 31 October 2017), aff'd, 186 A3d 799 (Table) (Del 2018).

and New York, have well-developed case law interpreting customary provisions in merger agreements, which allows the parties to take some comfort about the predictability of any litigation in those jurisdiction.

Similarly, certain jurisdictions' courts are more experienced and adept at adjudicating disputes involving complicated documents like merger agreements. Again, Delaware (especially the Delaware Chancery Court) and New York (including the Commercial Division) provide reliably qualified and competent jurists who understand the mechanics of a merger agreement. In the energy space, Texas judges are also more likely to be familiar with the subject matter. Parties to M&A transactions should, therefore, think carefully about their forum selection clause in order to mitigate against potentially negative results.

Parties may also consider mandatory arbitration clauses. Arbitration has many benefits, including the ability to select arbitrators with expertise in the energy field, faster proceedings and confidentiality. However, arbitration can have its downsides: arbitrators' judgments are typically not appealable, arbitration is expensive as the parties pay the costs of the arbitrator, and arbitrators may be more inclined to find a middle ground even where one party clearly has the better argument.

Jury waivers

M&A are inherently complex transactions, with intricate structures, deal terms, representations and warranties, and economics. As a result, any litigation over the terms of a merger agreement is also likely to involve complicated issues. Buyers and sellers should, therefore, insist on a jury waiver clause to avoid the risk of a jury of laypeople misunderstanding the complexities of the issues at stake in the litigation. Jury waivers should be drafted carefully to expressly and irrevocably waive the parties' right to a jury trial.

Indemnification

Merger agreements typically contain indemnification clauses. These are generally made in favour of the buyer, and the seller agrees to indemnify the buyer for claims arising out of a breach of the sellers' representations and warranties. Indemnity clauses should, therefore, be drafted precisely to fully capture the desired range of retained liabilities. Indemnity obligations are also typically subject to certain limitations, including floors and caps on liability. Recently, indemnity caps have dropped overall due to the increasing availability of RWI. Parties to M&A transactions should consider retaining counsel specialising in RWI to properly assess the potential liabilities associated with indemnification provisions.

XI OUTLOOK

i Oil and gas

Practitioners are cautiously optimistic about 2020. There remain significant headwinds to accelerated M&A activity because of the overall macroeconomic environment (including the outcome of trade negotiations with China) together with:

a bearish investor sentiment due to supply and demand concerns;
b geopolitical issues;
c negative associations about ESG issues at oil and gas companies;
d significant concerns about the amount and serviceability of indebtedness at many oil and gas companies; and
e expectations of lower growth capital expenditures.

While strategic deals may still get done at low or no premium of an unaffected stock price immediately prior to announcement, large premium strategic transactions will likely be relatively rare in 2020. Asset level deals will probably continue to remain subdued until commodity prices improve. In addition, regulatory concerns are likely to continue in 2020, stemming primarily from uncertainty surrounding the upcoming presidential election in November 2020, as several candidates have proposed a ban on the use of hydraulic fracking technology in the extraction of oil and natural gas. State concerns stem from similar issues around hydraulic fracking, but additional issues also relate to drilling setbacks and disposal wells.

The equity and debt capital markets will likely remain challenging for most oil and gas companies, with the exception of those companies with the best credit profile. Investors are looking for low levels of indebtedness, the visibility of free cash flow generation, and a return of capital through share repurchases or dividends. Many oil and gas companies will continue to be unable to satisfy investors' concerns in these areas, but conditions are expected to improve slightly for some oil and gas companies. Private equity companies will probably continue to serve as a source of alternative financing through the use of innovative deal structures. Nevertheless, the oil and gas industry will remain challenged in 2020, and there is likely to be an uptick in restructuring activity among the more highly levered companies.

ii Power and utilities

Dealmakers in the power and utilities sector remain optimistic regarding continued M&A activity within the sector despite a lack of recent megadeals, particularly as new investments in aging infrastructure, including technology, become increasingly necessary and the outlook for renewable energy transactions remains positive. While natural gas still dominates the power generation mix, we expect to see continued capital flows into renewables, and some convergence in the oil and gas and power sectors as oil and gas companies become a growing source of those capital flows. At the same time, as governments and investors continue to scrutinise certain conventional fuel sources (e.g., coal and nuclear), parts of the sector will face challenges, and potentially financial distress.

Appendix 1

ABOUT THE AUTHORS

SEAN T WHEELER

Kirkland & Ellis LLP

Sean T Wheeler is a corporate partner in the M&A and private equity practice group of the Houston office of Kirkland & Ellis LLP. He is also a member of the capital markets and energy and infrastructure groups. Sean's practice focuses primarily on M&A, joint ventures, securities offerings and corporate governance matters. He has significant experience representing public companies, master limited partnerships and private companies in the energy, power, and oil and gas industries, including his recent representation of Rowan Companies in a US$12 billion combination with Ensco, Newfield Exploration Co in its US$5.5 billion acquisition by Encana Corp, SemGroup Corp in its US$5.1 billion sale to Energy Transfer LP, Callon Petroleum Company in its US$3.2 billion acquisition of Carrizo Oil and Gas, Inc and Parsley Energy Inc in its US$2.27 billion acquisition of Jagged Peak Energy, Inc. Mr Wheeler has also led over 40 initial public offerings.

Mr Wheeler graduated *cum laude* from Harvard Law School in 1995. Sean has been recognised in industry publications including *Chambers USA*, *IFLR1000*, *Law360*, *The Legal 500 United States*, *Texas Lawyer*, *Texas Monthly*, *Law and Politics*, *The Best Lawyers in America* and *The Am Law Daily*.

KRISTIN MENDOZA

Kirkland & Ellis LLP

Kristin Mendoza is a corporate partner in the M&A and private equity practice group of the New York office of Kirkland & Ellis LLP. Kristin is also part of the firm's energy and infrastructure practice group. She represents private equity firms and strategic investors in their M&A activity, including joint ventures, throughout the life cycle of energy and infrastructure assets (e.g., development acquisitions, project financing equity arrangements, acquisitions and dispositions of operating assets), including oil and gas, conventional and renewable power, water and waste management, transportation and logistics, and telecom assets.

Prior to joining Kirkland, Kristin was an M&A partner in the New York office of Latham & Watkins LLP. She started her legal career at Clifford Chance LLP and also worked for one year as an in-house counsel on secondment at GE Oil and Gas, where she covered the Middle East, India and Africa from Doha and Dubai, advising on and negotiating

ROALD NASHI

Kirkland & Ellis LLP

Roald Nashi is a partner in the Washington, DC and Houston offices of Kirkland & Ellis LLP. Roald specialises in representing private equity sponsors on various forms of financings of energy and infrastructure assets in the power, oil and gas, mining and petrochemical sectors, including bank and bond financings, preferred equity and other mezzanine financings, leveraged lease, margin loan facilities and tax structured financings. Roald attended Cornell University, where he earned both a law degree and a PhD in logic.

ROBERT S FLEISHMAN

Kirkland & Ellis LLP

Robert Fleishman is a corporate partner in the Washington, DC office of Kirkland & Ellis LLP. Bob is a pre-eminent energy regulatory lawyer with deep experience on transactions, public policy, enforcement and compliance for a range of clients. Prior to Kirkland, he served in various capacities at the Federal Energy Regulatory Commission, was a former general counsel and vice president of corporate affairs at Constellation Energy and Baltimore Gas & Electric Company, and a lawyer at Covington & Burling and Morrison & Foerster.

Bob has been recognised in energy regulatory law by *Chambers USA*, *Best Lawyers in America* and *The Legal 500 US*. He was named by *The National Law Journal* in its list of 2017 energy and environmental trailblazers, and honoured by the Energy Bar Association (EBA) with the EBA President's Award for lifetime achievement (2019). He also served as editor-in-chief of the *Energy Law Journal* from 2005 to 2019, and is a past EBA president. Bob graduated with a BA in history, *cum laude*, from Georgetown University and a JD from Boston University School of Law.

KIRKLAND & ELLIS LLP

609 Main Street, Suite 4700
Houston, TX 77002
United States
Tel: +1 713 836 3600
sean.wheeler@kirkland.com

601 Lexington Avenue
New York, NY 10022
United States
Tel: +1 212 446 4800
kristin.mendoza@kirkland.com

1301 Pennsylvania Avenue, NW
Washington, DC 20004
United States
Tel: +1 202 389 5000
roald.nashi@kirkland.com
robert.fleishman@kirkland.com
www.kirkland.com

an LBR business

ISBN 978-1-83862-067-7