Matthew R. Pacey

Justin F. Hoffman

Oil and Gas Industry Practice Guide

by Matthew R. Pacey, P.C., Justin F. Hoffman, Michael W. Rigdon, and Christopher J. Fox, Kirkland & Ellis LLP

Overview

Question 1: Please describe the oil and gas industry and briefly discuss various types of companies and major players.

The energy industry is broadly separated into three main sectors:

- Upstream
- Midstream
- Downstream

The upstream sector, also known as the exploration and production sector, deals with the search for crude oil and natural gas fields and the subsequent drilling and operations required to recover crude oil and natural gas and bring it to the surface.

The midstream sector generally includes the transportation of oil and gas products, processing of such products, and the storage and marketing of those products.

The downstream sector refers to the refining of petroleum crude oil and the processing and purifying of raw natural gas, including the removal and production of sulfur, petrochemicals, and certain natural gas liquids as final end-products.

It should be noted, however, that the midstream sector is often defined to include certain elements of the downstream sector, such as natural gas processing in preparation for transportation and/or wholesale marketing. Additionally, downstream operations deal with the marketing and distribution of products derived from crude oil and natural gas that can include a variety of fuels, industrial products, and petrochemicals.

Beyond the upstream, midstream, and downstream sectors, the oil and gas industry also includes oilfield services companies that traditionally do not produce, transport, or refine petroleum themselves, but provide a number of crucial products and services for drilling, evaluation, completion, and production of oil and natural gas wells as well as often assist in pipeline construction.

The largest oil and gas companies in the world, often referred to as supermajors, include BP plc, Chevron Corporation, Exxon Mobil Corporation, Royal Dutch Shell plc, Total SA, and Eni. Certain state-owned oil and gas companies (such as China's CNPC and Sinopec or Saudi Arabia's Saudi Aramco) operate on a similar scale and generate similar revenues to the supermajors. The industry is also host to a number of smaller independent companies that operate within the upstream, midstream, or downstream operations or oilfield services segments, such as Anadarko Petroleum, Schlumberger, Hess Corporation, and many others. The emergence of U.S. shale production has turned many independent operators into larger players in the industry, and recently many of the supermajors, such as Exxon Mobil and Chevron, have shifted more of their capital budgets away from offshore oil and gas production towards U.S. shale plays.

Applicable Securities Laws and Regulations

Question 2: What are the relevant statutes and regulations governing securities offerings by oil and gas companies?

In addition to the statutes and regulations governing securities offerings generally (such as Section 5 (15 U.S.C.S. § 77e) of the Securities Act of 1933, as amended (the Securities Act), the exceptions from registration thereunder such as Section 4 (15 U.S.C.S. § 77d), Regulation S (17 C.F.R. § 230.901- § 230.905), and Regulation D (17 C.F.R. § 230.500 - § 230.508) promulgated under the Securities Act, and the majority of the rules included in Regulation S-K (17 C.F.R. § 229.10 - § 229.1208) and Regulation S-X (17 C.F.R. § 210.1-01 - § 210.12-29)), there are statutes and regulations that apply solely to offerings by oil and gas companies. For further information on the securities laws in general, see U.S. Securities Laws: An Overview. For further information on exemptions from registration, see Section 4 Exemptions from Securities Act Registration Checklist, Regulation S Offering Representations and Covenants, and Knowing the Components of Regulation D.

For example, Subpart 1200 (*17 C.F.R. §§ 229.12011208*) of Regulation S-K mandates certain disclosure by registrants engaged in oil and gas producing activities and requires the inclusion of summary reserve reports, as more fully described in Question 4(B) below.

Additionally, there are specific accounting rules that apply to the treatment of exploration activity costs. Costs associated with oil and gas drilling activities can either be accounted for on a company's financial statements based on the successful efforts or full cost methods. The choice of which method to utilize will govern whether certain costs will be capitalized and when such costs will be expensed. For a more detailed description of these accounting treatments, see Question 4(C) below.

Furthermore, midstream and pipeline companies that transport oil and gas interstate are subject to the Federal Energy Regulatory Commission (FERC), which regulates the transmission and wholesale sale of electricity and natural gas in interstate commerce as well as the interstate pipeline transportation of oil. FERC must approve any proposals to build interstate natural gas pipelines, natural gas projects, and liquefied natural gas terminals, although the agency primarily focuses on rates and access to pipelines and state regulations generally govern route approval for pipeline construction.

Lastly, there are also numerous federal and state environmental laws governing an oil and gas company, and any material effects that compliance with such laws may have on the company need to be disclosed in the securities offering document. In addition, Item 103 (17 C.F.R. § 229.103) of Regulation S-K requires disclosure of any administrative or judicial proceeding arising under a federal, state, or local provision governing the discharge of materials into the environment or protecting the environment, if such proceeding involves a governmental authority and potential monetary sanctions of $100,000 or more. Regulation S-K also requires, under Item 101 (17 C.F.R. § 229.101), that companies disclose material environmental capital expenditures for the current and succeeding fiscal year and any additional years that are material.

Securities Offering Process

Question 3: What is the typical process for securities offerings by oil and gas companies, including general steps, timeline, key transaction documents, due diligence process and required regulatory and stock exchange filings?

The oil and gas industry is extremely capital intensive, and companies often need to access the capital markets to fund their drilling programs and working capital needs. The general steps and timeline of a securities offering for oil and gas companies is similar in many respects to the process experienced by companies in other industries when they issue securities. The key parties include the company who plans to issue the securities, the underwriter (or initial purchaser in a Rule 144A (17 C.F.R. § 230.144a) offering or the placement or exchange agent in a direct private placement) who will market the sale, securities counsel for the company issuing the securities, and securities counsel for the underwriter. For further information, see Parties to a Securities Offering Checklist. For further information on Rule 144A offerings, see Understanding the Requirements of Rule 144A and Regulation S. The company's independent public accounting firm will also play a key role in the offering by providing the underwriters or initial purchasers with a comfort letter with respect to the financial information contained in the offering document. The accounting firm will also assist with answering certain audit or financial related diligence questions. See Conducting Accounting Due Diligence: Purpose and Process. One distinction in securities offerings for oil and gas companies is that, if the offering is by an exploration and production company, a reserve engineer will also be involved in the offering. The reserve engineer in essence is the auditor of the exploration and production company's oil and gas reserves, which are financial assets that the company's independent public accountant does not have the expertise to audit. The reserve engineer will assist in the diligence process by answering the underwriters' or underwriter counsel's questions with respect to reserve data and will also provide an opinion with respect to reserve estimates included in the offering document.

Although securities offerings by oil and gas companies generally follow the same structure and process as typical securities offerings for most of the key transaction documents, there are nuances that a practitioner should know when advising a client on such an offering, as noted below.

For further information on securities offerings in general, see Initial Public Offerings Resource Kit, Follow-On Offerings Resource Kit, and Private Placements Resource Kit.

Underwriting Agreement

The underwriting agreement in a securities offering by an issuer engaged in the oil and gas business follows the same form as a typical underwriting agreement. Certain representations and warranties are slightly more robust, and there may be additional deliverables. For example, counsel will focus heavily on the environmental representations and warranties and the title representations and warranties, both with respect to the clear ownership of reserves and certain right-of-way rights for pipelines. Additionally, similar to obtaining a comfort letter from the issuer's independent auditor, underwriters will require an exploration and production company to obtain a letter from its external reserves engineer providing comfort on specified oil and gas reserves information that is included in the offering document. This is referred to as a reserves engineer letter or a reserve report confirmation letter and is an especially important part of the diligence/comfort process in an offering by an issuer engaged in the exploration and production business. For additional information regarding the underwriting agreement in securities offerings by oil and gas issuers, see Question 5 below. For further information on underwriting agreements, see Understanding the Key Agreements in an IPO — Underwriting Agreement. For forms of underwriting agreements in various other contexts, see Underwriting Agreement, Agreement Among Underwriters (IPO), and Underwriting Agreement (Combined Primary and Secondary Offering).

Due Diligence Process

The diligence process in securities offerings by oil and gas companies is different from other securities offerings because of the numerous disclosures beyond financial information that drive the price of the securities to be sold in the offering. For exploration and production companies, diligence includes a thorough review of backup and supporting information for oil and gas reserves, related operational information, acreage data, and production numbers disclosed in the offering document. A practitioner should review not only the company's external and internal reserve reports, but also the lease and title information for the mineral rights associated with the issuer's reserves, especially with respect to secured financings. Firms that have an extensive practice representing oil and gas companies will typically have a specialist knowledgeable of oil and gas leases and contracts governing mineral rights (also known as a landman) in-house that can assist with this diligence. For midstream companies, it is important to diligence any right-of-way or pipeline permitting issues and engage specialists versed in FERC rules and regulations for certain regulatory matters when appropriate. Environmental specialists should always be involved and thoroughly review any potential or past environmental violations, proceedings, or capital expenditures that may warrant disclosure in the offering document. For additional information on oil and gas company due diligence, see Management Due Diligence Questions for an Energy Producer. For additional information on due diligence in securities offerings in general, see Due Diligence for Securities Offerings Resource Kit. Due Diligence Interviews, and Management Due Diligence Questions.

Investor Presentation

Disclosure in the investor presentation for securities offerings by oil and gas companies is often more extensive and forward-looking than typical securities offerings. In particular, issuers will want to include specific information and charts related to their production profile, including type curves (which show forecasted production quantities and expected declines in production from a well over time) and additional reserves data that does not conform to Securities and Exchange Commission (SEC) rules for reserves. The additional reserve information may include reserve numbers based on the pricing of futures contracts (such as prices listed on the New York Mercantile Exchange, or NYMEX, and commonly referred to as "strip pricing") versus SEC pricing. There is also no rule analogous to Regulation G (17 C.F.R. § 244.100 - § 244.102) for financial information that would require presenting and reconciling this non-conforming data to a prescribed conforming number or figure. Additionally, it is more common for oil and gas issuers to provide guidance in the investor presentation for items such as planned capital expenditures and certain expense numbers. Despite the general advice of securities practitioners to avoid guidance in both offering documents and accompanying presentations, oil and gas issuers regularly include additional operational guidance, such as production forecasts, in the investor presentation, especially when a transformative acquisition, divestiture, or other event has changed the company's prior projections. As with any securities offering, counsel should explain the risks of including such information in offering materials and in most situations, advise the client to remove such guidance from the investor presentation. If the client insists on including it, counsel should generally recommend a separate diligence call with management and reserve engineers and add such information to the offering document itself. For further information regarding investor presentations, see Preparing for a Road Show.

Debt Covenants

There are numerous differences in debt securities offerings by oil and gas issuers, specifically within the covenants in their indentures. While an analysis of these differences would require an article of its own, a few of the differences include:

- A credit facility basket sized by reference to (x) a borrowing base concept tied to the reserve-based credit agreement, (y) a percentage of "Adjusted Consolidated Net Tangible Assets," and/or (z) a dollar amount
- Various non-indebtedness lien exceptions for ordinary course business activities
- A broad concept of "Permitted Business Investments" permitting various joint venture and joint development activities which are customary in the industry
- A more onerous test for the incurrence of unsecured debt under a fixed charge coverage ratio of 2.25 to 1 (instead of the typical 2.0 to 1)
- For secured deals, a mortgage covenant that often requires the delivery of an officers' certificate certifying compliance with a minimum collateral coverage requirement based on proved reserves (typically 85-90%)

For additional information on debt covenants, see Covenants: High Yield vs. Investment Grade. For a form of indenture including covenants, see Indenture.

Disclosure Obligations

Question 4: What information must be made available to potential investors in connection with securities offerings by oil and gas companies?

A. Risk Factors

Please describe the common risk factors that are specific or unique to issuers in this industry. Have there been any recent developments or changes that counsel should be aware of when preparing these risk factors?

There are numerous risk factors that are unique to the oil and gas industry and a practitioner should carefully review this section of the offering document in order to tailor an issuer's risk factors to meet the specific risks of the client's business. Certain key risks are noted below. For additional information on risk factors in general, see How to Draft Risk Factors for a Registration Statement and Market Trends: Risk Factors.

- **Risk related to the development of undeveloped reserves or PUDs.** Risks related to the ability to drill and produce proved undeveloped reserves, or PUDs, should be fully disclosed. For example, SEC rules require that an issuer's capital program provide for the drilling and completion of PUDs within five years of booking the PUD. In low price environments, oil and gas companies will often have to reduce their capital spending and as a result, the amount of PUDs can significantly decrease. Furthermore, there is no guarantee undeveloped reserves will be developed and this should be adequately disclosed. As reserves are a declining asset, oil and gas companies must continue to produce resources from existing properties and/or acquire producing properties in order to remain viable.
- **Impairments to the carrying values of oil and natural gas properties.** The offering document should also include risk factors related to the potential impairment of oil and gas reserves and the write-down of the carrying values of the registrant's oil and natural gas properties should be included. As described under Question 4(C), if the carrying value of oil and natural gas properties for a company exceeds the present value of such reserves, the company will be required to take a write-down to the carrying value of such reserves reflected as assets on the company's balance sheet. This is especially true with companies that utilize the full cost method of accounting which requires a quarterly ceiling test to determine if impairment is necessary. The company's internal auditors and outside auditors should be consulted to determine if impairments are expected. If impairments are expected, a practitioner should add additional detail regarding any expected decrease in the carrying values of oil and natural gas properties and disclose the implications of any such decrease, including any potential reductions in a credit facility borrowing base or other adverse liquidity consequences.
- **Volatility of oil and natural gas prices.** Oil and gas companies should include a risk factor to address the volatility of commodity prices and the risk of cash flow volatility if hedges are not replaced. The risks related to the company's commodity hedging program should also be fully addressed.

- **Assumptions in determining the value of oil and gas reserves.** A risk factor should address the assumptions that are used in estimating the value of oil and gas reserves and the risk that those assumptions will materially affect the quantities and estimated present value of reserves.

- **Liquidity risks, including the risk of a borrowing base reduction under the credit facility.** Due to the volatility in oil and gas prices, liquidity risk may be a realistic threat to an oil and gas company and should be appropriately disclosed. For example, a decrease in the value of oil and gas reserves, potentially driven by a decrease in commodity prices, may result in a subsequent borrowing base reduction for the registrant's credit facility. A borrowing base reduction will result in less liquidity for the company and also may trigger deficiency payments if the borrowing base is reduced below the amount borrowed under the facility. This risk is related to the potential for impairments noted above. If the company has experienced a significant impairment or expects one to occur, a practitioner should carefully analyze and disclose the likelihood of a borrowing base reduction under the company's credit facility.

- **Risks related to the implementation of new technology.** Technology related to oil and gas drilling and fracturing activities changes quickly. If a company does not appropriately adopt these new technologies, their competitive position may decline. This risk is especially important for energy services companies that must employ the latest in technology to remain competitive and maintain market share.

- **Regulatory risks.** The oil and gas industry is subject to extensive regulations, including environmental regulations related to the handling and disposal of hazardous materials, wastewater discharges, air emissions, and endangered species, among others. The appropriate specialists should be engaged to ensure all regulatory risks are addressed.

- **Concentration of suppliers and customers, and geographic concentration of operations.** In the oil and gas industry it is not uncommon for a company's suppliers or customers to be somewhat concentrated. Where this is the case, the company should disclose that it is highly dependent on a few suppliers or customers and discuss the accompanying risks. Additionally, risks associated with any geographic concentration of operations should be disclosed.

B. MD&A and Business

Please provide the key discussion points that counsel should consider when preparing the business and MD&A sections for issuers in this industry.

Counsel should consider including a number of additional disclosures in the Business and Management's Disclosure and Analysis (MD&A) sections for clients in the oil and gas industry.

For issuers engaged in oil and gas producing activities, Subpart 1200 of Regulation S-K requires, among other things:

- Additional disclosure regarding proved developed and undeveloped oil and gas reserves

- Inclusion of a third-party reserve report in certain instances

- Disclosure of production, prices, and costs

- Disclosure of productive and dry exploratory and development wells, delivery commitments, and certain acreage information

The SEC typically will focus on compliance with Subpart 1200 when reviewing and issuing comment letters to oil and gas issuers, whether with respect to an initial public offering registration statement, shelf registration statement, or periodic disclosure under the Securities Exchange Act of 1934. Counsel should survey recent SEC comment letters that address Subpart 1200 of Regulation S-K to ensure their client's disclosure (especially in connection with an initial public offering) appropriately addresses positions taken in any recent SEC comments. Additionally, issuers engaged in exploration and production activities will typically disclose production data and pricing data in MD&A, as well as certain more detailed expense information on a per unit of production basis, including items such as lease operating expense, impairments, gathering and transportation expenses, and depreciation.

An item that has received a renewed focus by the SEC in the current lower oil and gas price environment is disclosure of PUDs. The SEC has frequently issued comments with respect to an issuer's disclosure of PUDs and specifically with respect to how such issuer's development plan provides for the development of PUDs within five years of booking, known as the five-year rule. In a low oil and gas price environment, especially with many oil and gas companies facing liquidity constraints, the five-year rule for booking PUDs often results in a somewhat significant reduction in the amount of PUDs disclosed as companies no longer have the necessary liquidity to drill or it is less economic to drill at the same rate as in higher price environments. Recently due to the low-price environment, some issuers have been required to remove disclosure of PUDs altogether due to significant reductions in their capital spending plan.

Issuers engaged in midstream activities will often break down revenues disclosed in MD&A into various segments such as transportation services, sales of oil and gas from marketing activities, and processing. For companies in the midstream business that focus their operations on transportation services, it is common to also include disclosure of throughput volumes in MD&A.

Issuers in the oil and gas industry will typically include disclosure regarding gains or losses with respect to their commodity derivative contracts and disclosure regarding environmental and other regulatory matters. Commodity derivative contracts can have significant value for an oil and gas company, especially when prices are volatile, and the company's use of such contracts to smooth revenues and hedge against risk should be appropriately disclosed in MD&A.

Environmental and regulatory disclosure has become increasingly important for oil and gas companies. For example, with the heightened focus on fracking and increased earthquake activity in certain areas, disclosure in the business section and in the risk factors should include detail regarding any restraints or potential restraints to operations that the issuer believes could be imposed upon it by federal and state regulatory bodies.

C. Other Prospectus Disclosure

Is there any other additional or special disclosure that should be included in the prospectus or registration statement for issuers in this industry, either required by the SEC or from market practice?

Rule 4-10 (17 C.F.R. § 410.4-10) of Regulation S-X governs financial accounting and reporting for oil and gas producing activities and also contains many of the definitions for certain oil and gas related terms that are used in disclosure and throughout the SEC's rules and regulations. Specifically, Rule 4-10 provides the definitions for proved oil and gas reserves, probable reserves, and possible reserves, among others. Proved reserves are defined as those quantities of oil and gas reserves which can be estimated with reasonable certainty to be economically producible. In calculating proved reserves, the SEC stipulates that the pricing mechanism that should be used is the average price during the 12-month period prior to the report, determined as an un-weighted arithmetic average of the first-day-of-the-month price for each month within such period (SEC Pricing). Probable reserves are those reserves that, together with proved reserves, are as likely as not to be recovered. Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. Although the SEC prescribes the use of SEC Pricing in disclosure/offering documents filed with the SEC, companies will often vary from SEC Pricing in lender calculations and Adjusted Consolidated Net Tangible Assets (ACNTA) calculations and use NYMEX strip pricing.

Additionally, there are specific accounting rules that apply to capitalizing or expensing certain costs of oil and gas exploration and production companies. Costs associated with oil and gas drilling activities can either be recorded on a company's financial statements based on the successful efforts or full cost methods. Companies who choose to use the successful efforts method expense the cost of drilling dry holes, or unsuccessful drilling efforts, as such costs are incurred, whereas companies utilizing the full cost method will capitalize all such costs, including costs of unsuccessful drilling efforts, in the carrying value of their oil and gas properties on their balance sheet to be expensed later through the recognition of depreciation expense. Both methods require the periodic impairment of oil and gas properties if the balance sheet value exceeds the present value of such reserves; however, it is more common to have impairment recognition when the full cost method is employed due to the often higher relative carrying value of oil and gas properties as a result of the capitalization of certain unsuccessful drilling and other costs as mentioned above. Additionally, companies who utilize the full cost method will perform a quarterly ceiling test to determine if any impairment is necessary, whereas companies who utilize the successful efforts method will typically perform a test for impairments annually. Issuers should include detailed disclosure regarding their use of the successful efforts or full cost methods, as the choice of which method to use can substantially change how the value of reserves are presented in the issuer's financial statements. The company's auditors will focus heavily on this disclosure as well. The rules that govern the use of the successful efforts method and full cost method can be found in Rule 4-10(b) of Regulation S-X.

An important additional disclosure point for oil and gas companies that stems from the comparability of financial metrics for companies that utilize the successful efforts method versus the full cost method is the comparability of earnings before interest, taxes, depreciation, and amortization (EBITDA). As a result of full cost companies capitalizing a larger amount of costs and depreciating those costs over time, as opposed to successful efforts companies expensing unsuccessful drilling costs as incurred, the add-back of depreciation in EBITDA, as well as the lower expense figure for full cost companies, often results in a different EBITDA number for full cost companies. To adjust for this discrepancy, many successful efforts companies will employ EBITDAX to add back exploration expense.

D. Additional Disclosure Issues

Please discuss any other special disclosure issues or advice applicable to issuers in this industry.

For purposes of acquired business financial statements required by Rule 3-05 (17 C.F.R. § 210.3A-05) of Regulation S-X, the Division of Corporation Finance's Financial Reporting Manual recognizes a working interest in an oil and gas property as a business. See Section 2010.4 of the Financial Reporting Manual, which can be found at https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml. As a result, acquisitions of oil and gas interests should be analyzed to determine if any of the significance thresholds of Regulation S-X are exceeded and whether acquisition financials will be required to be filed with the SEC. Additionally, Sections 2065.11 and 2065.12 of the Division of Corporation Finance's Financial Reporting Manual permit the use of short-form financial statement requirements for acquisitions of oil and gas interests if certain conditions are met. However, it is important to note this reduced financial statement requirement does not apply outside of the Regulation S-X 3-05 context. Therefore, in the context of a securities offering where the acquired business represents the predecessor of the registrant, this guidance would not apply, and an issuer would be required to prepare an audit for the acquired properties.

There are also additional disclosure considerations when conducting a securities offering of a master limited partnership (MLP). An MLP is a limited partnership or limited liability company that issues units, as opposed to shares of stock, representing ownership interests in the underlying limited partnership or limited liability company. MLPs are tax pass-through entities and subject to a few exceptions, do not pay any federal income taxes at the entity level. See Taxation of Publicly Traded Partnerships. Unitholders of the MLP will receive regular distributions from the MLP, and such distributions will be subject to tax at such unitholder's individual tax rate. Given the complex structure governing distributions and also the unique governance rights in an MLP, registrants should provide fulsome disclosure regarding the partnership agreement, how cash distributions are made, and the governance structure, including additional disclosure on potential conflicts of interest between the MLP and the sponsor. MLP registration statements for initial public offerings will also include financial information which reflects cash available for distribution on a go forward basis and on a historical basis pro forma for the offering, commonly referred to as the forecast and back-cast. Additionally, unlike corporate issuers engaged in oil and gas operations, certain offerings by limited partnerships are not required to comply with SEC Industry Guide 2.

Underwriting Agreements

Question 5: What types of underwriting arrangements are commonly used? What are some of the standard clauses and clauses that are heavily negotiated in an underwriting agreement in connection with an offering by an oil and gas company?

When conducting a securities offering by an oil and gas issuer, a practitioner will start with the standard bank form of underwriting agreement that is used for energy and non-energy deals. For offerings that are by partnerships such as MLPs, many banks will have a separate MLP form of underwriting agreement that will be used for the transaction. Practitioners should check with the bank's in-house legal counsel to determine the preferred form to use.

A practitioner should tailor certain of the representations and warranties to the specific asset profile of the issuer. For instance, in an offering by an exploration and production company, legal counsel should revise the typical title and environmental representations to appropriately address the value and nuanced risk associated with owning oil and gas reserves and pulling such reserves out of the ground. In offerings by a midstream company, legal counsel should also focus carefully on these representations and warranties, especially with respect to clear ownership of certain right-of-way rights for pipelines.

Additionally, similar to obtaining a comfort letter from the issuer's independent auditor, an exploration and production company will agree in the underwriting agreement to obtain a letter from its external reserves engineer providing comfort on certain oil and gas reserves information that is included in the offering document.

The additional focus on these representations and warranties and the inclusion of the reserves engineer letter requirement would apply in both private and public debt and equity offerings.

Continuous Disclosure and Corporate Governance

Question 6: What specific continuous disclosure and corporate governance requirements apply to oil and gas companies?

Generally, the same SEC and stock exchange corporate governance requirements apply to oil and gas companies as would apply to other companies. However, as discussed in Question 7 below, there are relaxed requirements under the applicable exchange's rules for limited partnerships, such as MLPs.

With respect to continuous disclosure obligations, the major difference is the requirement for oil and gas companies to comply with Subpart 1200 of Regulation S-K as further described in Question 4(B).

For further information on continuous disclosure and corporate governance in general, see Periodic and Current Reporting Resource Kit, Financial Statements and Reporting Resource Kit, Audit Committee Resource Kit, and Proxy Statement and Annual Meeting Resource Kit.

Stock Exchange Requirements

Question 7: Are there any special listing or corporate governance standards required by major stock exchanges, including NYSE and NASDAQ?

Stock exchange rules, including for the New York Stock Exchange (the NYSE) and the NASDAQ Stock Market (NASDAQ), and SEC rules and regulations that govern listing and corporate governance standards apply equally to oil and gas companies and do not differ in any material fashion for issuers engaged in the oil and gas industry. As mentioned above in Question 6, however, there are relaxed requirements for limited partnerships which would apply to oil and gas MLPs. For instance, unlike public corporations, MLPs are not required to have a majority of independent directors and are excused from needing a compensation committee and a nominating and corporate governance committee. Additionally, MLPs are exempt from the majority of the shareholder approval rules of the NYSE and NASDAQ. For further information on NYSE and NASDAQ requirements, see Complying with NYSE and Nasdaq Listing Requirements, NYSE Corporate Governance Listing Requirements Table, and NASDAQ Corporate Governance Listing Requirements Table.

Other Key Laws and Regulations

Question 8: What are other key laws and regulations that a securities lawyer working with an oil and gas company needs to be aware of?

Many oil and gas companies in conducting their initial public offering (IPO) will qualify as an emerging growth company, or an EGC, and as a result, will be able to benefit from reduced disclosure requirements. An issuer that qualifies for EGC status will retain that status until the earlier of (i) the end of the fiscal year in which its annual revenues exceed $1.07 billion, (ii) the end of the fiscal year in which the fifth anniversary of its IPO occurs, (iii) the time at which on a three-year rolling basis the issuer has issued over $1 billion of non-convertible debt, and (iv) the date the issuer is a large accelerated filer. If a company qualifies as an EGC, it is allowed to present only two years of audited financials in its initial public offering registration statement instead of three years, including the accompanying discussion of financial periods in MD&A, and provide reduced compensation disclosure similar to the disclosure requirement for a smaller reporting company. Additionally, an EGC can initially submit an IPO registration statement confidentially with the SEC, test the waters before proceeding with an offering, and avail itself of numerous other permissions. For additional information on EGCs, see Emerging Growth Company Practice Guide.

There are numerous environmental rules and regulations at both the federal and state level that a securities lawyer should be aware of when representing a client in the oil and gas industry. These rules and regulations are often detailed and require a high degree of specialization. As a result, a securities lawyer should involve their firm's environmental specialist to review and analyze an issuer's compliance with and liabilities under environmental rules and regulations.

Additionally, a securities lawyer involved with an offering by a company engaged in the midstream business should carefully consider any FERC rules or regulations that might apply to an issuer engaged in the interstate transportation of oil and gas. It is not uncommon for a securities lawyer to engage a FERC specialist, whether in their firm or at a third party, to assist with this diligence and review.

Furthermore, tax specialists should be engaged to review tax disclosure and properly diligence any tax items with the company. This is especially true for MLPs, and a tax specialist versed in partnership tax should be involved.

Regulatory Trends

Question 9: What are the major regulatory trends affecting oil and gas companies?

When it comes to regulatory trends in the energy industry, no two areas of interest have drawn more attention in recent years than hydraulic fracturing and climate change. With respect to hydraulic fracturing, or fracking, the U.S. government and various states and local governments have begun moving towards regulating, and in some cases restricting, fracking activity. One of the more prominent trends at the state regulatory level has been the movement to require oil and gas companies to publicly disclose the chemicals used in hydraulic fracturing fluids. Several states (including Wyoming, Arkansas, Michigan, Texas, West Virginia, and Montana, to name a few) have passed disclosure laws for the chemicals in these fluids. Additionally, given increased earthquake activity near certain waste water disposal sites for fracking fluid, some states, such as Oklahoma, have begun to regulate and limit disposal activity in certain areas that are seeing increased seismic activity. The shift to more unconventional drilling techniques continues to create new regulatory and environmental issues as laws adapt to the new drilling environment. Furthermore, the political landscape often can play an important role in the regulations that will be implemented to address these issues.

On the issue of climate change, the U.S. Environmental Protection Agency (EPA) has focused on regulating methane emissions in the oil and gas sector. In May 2016, the U.S. EPA issued new emissions standards that aim to reduce methane and other emissions from new or modified oil and gas sources, whether through capturing emissions from compressors and pneumatic pumps or through requiring periodic surveys to identify any other fugitive emissions sources.

There has, however, been a trend toward deregulation in the oil and gas industry. In March 2017, the Trump administration issued an executive order with the goal of rolling back certain aspects of various Obama-era environmental regulations, including the Clean Power Plan and Climate Action Plan, both policies aimed at reducing carbon and methane emissions. Currently, implementation of the Clean Power Plan, which limits carbon pollution from power plants to a level set by state governments within certain parameters, has been stayed by the U.S. Supreme Court pending a challenge in the U.S. Court of Appeals for the District of Columbia Circuit. In addition, the U.S. House of Representatives seems to be of the same mind as the administration. In early February 2017, the House voted to eliminate rules promulgated by the Bureau of Land Management (BLM) reducing methane emissions from venting, flaring, and leaks during oil and gas operations using the Congressional Review Act (the CRA). The CRA requires majority approval of the Senate and the approval of the President to officially repeal these BLM methane rules, but, if such approvals are received, the BLM would be prohibited from issuing similar rules without express authorization from Congress.

Additionally, in 2010, the SEC provided interpretative guidance that is intended to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as issuers prepare disclosure documents.

In April 2016, the SEC sought comments on expanding climate change and other environmental, social and governance disclosure requirements.

Commercial Trends

Question 10: What are the major commercial trends affecting oil and gas companies?

The precipitous drop in oil prices in late 2014 has highlighted one of the most persistent trends in the oil and gas industry: Price volatility. Because oil and gas prices are linked to a number of geopolitical issues outside the business purview, they are often unpredictable. Since late 2014, the market has been glutted with oil and gas supply, and the prices have remained low, prompting many oil and gas companies to avoid capital intensive projects. Additionally, the low price of crude oil and relative unpredictability of the market has led a number of oil and gas companies to either pay less to their suppliers or delay payment, creating a problem for certain companies.

Also, initially as the price of crude oil dropped, the nature of deals happening in the capital market space shifted. IPO activity and traditional new money unsecured bond deals slowed, and companies turned to alternative sources of cash for liquidity. These alternative sources of cash included debt exchanges, secured bond deals, institutional term loans, private investment in public equities, or PIPEs, and significant involvement by private equity investors. For additional information on some of these alternative sources of cash, see U.S. Securities Laws Applicable to Debt Exchange Offers and Cash Tender Offers Chart, Pricing and Closing an Issue of Bonds, Market Trends: PIPEs, and Dodd-Frank and Private Equity—Then and Now. There was also an increase in both in- and out-of-court restructuring transactions and such activity may continue for some companies as they are forced to deal with upcoming maturities and liquidity concerns. In such situations, there are numerous securities issues which must be addressed, including selective disclosure, offering exemption concerns, consent solicitation issues, covenant compliance concerns, and governance rights. As the price of crude oil has begun to stabilize and increase, we have seen an increase in IPO planning and activity which we expect to continue.

Furthermore, over the last ten years the increased use of unconventional drilling techniques, such as horizontal drilling, has resulted in a shift in the equipment and services needed to complete a well. As this shift continues, the equipment and services needed in this industry become more complex, which creates demand for complex product offerings by energy services companies.

Practice Tips

Question 11: What practice points can you give to lawyers working with oil and gas companies?

The market precedent and practice in the oil and gas industry can be unique and varied from the capital markets traditionally seen in other industries in many ways. The oil and gas industry has over the years developed its own market terms and acceptable covenants and structures for deals. The cyclical nature of the industry also impacts the types of transactions and structures utilized at any given time. A practitioner should keep this in mind when representing oil and gas companies, as the uniqueness of the oil and gas market is generally accepted and understood within that market. Additionally, a basic understanding of the fundamentals of the oil and gas industry, such as basic geology, drilling techniques, reserve classifications, and other industry-specific items, is very important in effectively representing an issuer in the oil and gas space. One should talk to an experienced counsel that has a strong oil and gas practice when approaching a securities offering by an oil and gas company.