

THE ENERGY MERGERS
& ACQUISITIONS
REVIEW

FOURTH EDITION

Editors

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

THE LAWREVIEWS

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UNITED STATES

*Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert 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).

There was meaningful improvement in the oil and gas industry in 2022. Commodity prices improved dramatically over the course of the year because of favourable supply and demand dynamics, the Russian invasion of Ukraine and more disciplined capital spending by the industry. As a consequence, investors started returning, somewhat timidly, to the oil and gas sector, which resulted in material outperformance compared with the Standard and Poor's 500 index. The year 2022 revealed a return of confidence in future growth and a significant increase in overall mergers and acquisitions (M&A) activity in the sector, although the volume of M&A activity is well below all-time highs.

The debt capital markets have opened for most oil and gas companies, with refinancing and more favourable terms being offered to companies in the oil and gas industry. The equity capital markets remain challenged for new issues, but, as described above, 2022 share performance for public companies has been impressive. As in years past, investors are looking for low levels of indebtedness, visibility of free cash flow generation, and a return of capital through share repurchases or dividends. Oil and gas companies are increasingly responding to these demands, with favourable reaction from their investors. Private equity investment in the oil and gas industry increased in 2022 compared with recent years, as these companies continue to offer an alternative source of financing through the use of various deal structures, including drillcos, wellbore securitisations and non-op joint ventures (JVs).

¹ Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert Fleishman are partners at Kirkland & Ellis LLP. The authors would like to thank the following lawyers at Kirkland, who contributed to this report: Ben Barnes, Brooksany Barrowes, Chuck Boyars, Zach Brez, Jennifer Cornejo, James Dolphin, Kathy Dzienkowski, Lucille Hague, Sophia Han, Christopher Heasley, Carla Hine, Ian John, Jonathan Kidwell, Erika Krum, Savannah Malnar-Cole, Mario Mancuso, Charles Harold Martin, Michael Masri, Nick Niles, Anna Rotman, Ahmed Sidik, Chad Michael Smith, Paul Tanaka, Calvin Jonathan Vaughan and David Wheat.

Many generalist investors still seek greater commitment to environmental, climate and ‘environmental, social and governance’ (ESG) objectives, and companies in the oil and gas sector have responded with significant efforts to address these concerns, with some even committing to be carbon neutral by 2050. Environmental, climate and ESG efforts will continue to be a major source of focus for oil and gas investors and companies in the industry.

ii Power and utilities

The power and utilities sector saw a decrease in M&A activity in the first half of 2022 compared with 2021 levels, in terms of both deal activity and deal value.² Prospective market participants faced headwinds in the first half of 2022 because of a variety of macroeconomic factors such as inflation, increases in interest rates, supply chain issues and uncertain federal energy and infrastructure policy.³ However, the Inflation Reduction Act (IRA), which was passed in August 2022,⁴ alleviated some federal policy uncertainty and has provided significant tax incentives for future investments in renewable energy.

Corporate deals and inbound investments have been significant contributors to power and utilities transaction activity in 2022 – this has become a more stable trend as dealmakers seek investments in early-stage growth companies focused on technology and innovation in the energy sector such as battery and other advanced energy storage solutions, advanced nuclear and hydrogen energy, carbon capture and renewables (including renewable natural gas).⁵ In the first three quarters of 2022, financial participants accounted for roughly 25 per cent of total deal value, a slight increase from 2021, where financial participants accounted for roughly 20 per cent of deal value.⁶ Despite a decrease in US power and utilities M&A activity generally in 2022, interest in renewable energy deals has remained strong and contributed significantly to US power and utilities M&A activity during the year. Renewable energy deals represented over 37 per cent of US power and utilities M&A value in the 12-month period ending 15 May 2022.⁷ This trend is expected to continue as recent legislation and continued development in the renewable energy sector is likely to drive even more M&A activity in the years to come. It is estimated that the United States will have added an additional 46.1GW of utility-scale electric generating capacity in 2022, of which 74 per cent will come from solar, battery and wind energy sources.⁸

2 ‘Power and utilities: Deals 2022 midyear outlook’, PwC, <https://www.pwc.com/us/en/industries/energy-utilities-resources/library/power-utilities-deals-outlook.html>.

3 *ibid.*

4 ‘House Passes Manchin’s Inflation Reduction Act’, Senate Committee on Energy & Natural Resources, <https://www.energy.senate.gov/2022/8/house-passes-manchin-s-inflation-reduction-act>.

5 ‘Power and utilities: Deals 2022 midyear outlook’, PwC, <https://www.pwc.com/us/en/industries/energy-utilities-resources/library/power-utilities-deals-outlook.html>.

6 Percentages calculated from transaction statistics found on S&P Capital IQ Pro; ‘S&P Capital IQ Pro’, S&P Global Market Intelligence, <https://www.spglobal.com/marketintelligence/en/campaigns/sp-capital-iq-pro>.

7 *ibid.*

8 ‘Solar power will account for nearly half of new U.S. electric generating capacity in 2022’, U.S. Energy Information Administration, <https://www.eia.gov/todayinenergy/detail.php?id=50818>; ‘Inflation Reduction Act could help utilities sell competitive renewables assets’, S&P Global, <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/inflation-reduction-act-could-help-utilities-sell-competitive-renewables-assets-71694342>.

In 2022, a wide range of participants were active in the power and utilities M&A space. Traditional oil and gas companies, public utilities, independent power producers and financial sponsors all engaged in transactions that were motivated by ESG initiatives or the desire to accelerate the energy transition. This is exemplified by the largest power and utilities sector M&A deal in the first half of 2022, in which the Infrastructure Investments Fund (IIF), advised by a dedicated investment group within JP Morgan Investment Management Inc, acquired South Jersey Industries, Inc for US\$7.8 billion. The transaction is expected to give the New Jersey utility key financial resources to meet its commitment to carbon-neutral operations by 2040. In October 2022, Renewables Americas, LLC (RWE) made a strategic acquisition of Con Edison Clean Energy Businesses, Inc (ConEd), for US\$6.8 billion. The transaction helped RWE accelerate growth of its renewable energy business. A few weeks later, British Petroleum plc (BP) acquired Archaea Energy Inc for US\$4.1 billion. The move will help accelerate BP's expansion into renewable natural gas generation.

Policy shifts at the federal level have had meaningful impacts on renewable energy M&A activity. In August 2022, the IRA was passed into law. The IRA reinstates and expands renewable energy tax incentives for solar and wind, creates new tax incentives for investment in energy transmission, hydrogen energy, electricity storage, carbon capture and alternative energy sources, and increases flexibility with respect to financing energy projects through transferable tax credits. The IRA's tax incentives are projected to increase the value of renewable energy projects in the development pipeline.⁹ US-based energy companies may seek to take advantage of increases in project value by selling commercial renewable energy portfolios through asset sales.¹⁰ Alternatively, renewable energy companies may seek growth equity investments from financial sponsors to fund future clean energy project development and, therefore, capitalise on favourable tax incentives of the IRA. Brookfield Renewable Partners' recent acquisitions of Scout Clean Energy LLC and Standard Solar, Inc, for US\$1 billion and US\$540 million respectively, are key examples of this type of transaction with a financial sponsor.¹¹ Under the terms of each transaction, Brookfield Renewables retained the right to make additional investments into the target business to support further renewable energy development activity. Additionally, other legislative advancements are also likely to spur investments into US energy power and transmission. For example, the US\$1.2 trillion Infrastructure Investment and Jobs Act in 2021 set aside billions of dollars in federal funding for clean hydrogen, electricity grid modernisation, and expansion of the supply chain through clean energy.¹²

9 'Inflation Reduction Act could help utilities sell competitive renewables assets', S&P Global, <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/inflation-reduction-act-could-help-utilities-sell-competitive-renewables-assets-71694342>.

10 *ibid.*

11 'Brookfield to invest up to \$2 billion in Scout Clean Energy and Standard Solar', Brookfield, <https://bep.brookfield.com/press-releases/bep/brookfield-invest-2-billion-scout-clean-energy-and-standard-solar>.

12 'Energy funding in the Infrastructure Investment and Jobs Act', U.S. Chamber of Commerce, <https://www.uschamber.com/infrastructure/energy-funding-in-the-infrastructure-investment-and-jobs-act>.

II YEAR IN REVIEW

i Oil and gas

Asset-level M&A activity has been robust in 2022, reflecting a return to the mean from the pandemic deal activity level, and increased consolidation throughout the onshore basins (including the US\$5.2 billion purchase of Appalachian Basin assets by EQT from Tug Hill and the US\$865 million purchase of Williston Basin assets by Devon from RimRock Oil & Gas LLP). Interest in asset deals has increased, although increasing and volatile commodity prices have created somewhat of a valuation disconnect between buyers and sellers. This disconnect has led to an increased use of stock consideration and commodity price-based earnouts. There remains a generalised concern that the Biden administration will continue to implement limitations on the use of hydraulic fracking technology in the extraction of oil and natural gas, and promulgate more stringent environmental regulations in general, and this has already been reflected to some extent in regulatory rule-making actions. State concerns stem from similar issues related to hydraulic fracking, drilling setbacks and disposal wells.

In 2022, the number of strategic deals – those involving public companies in the oil and gas industry – has increased over those in 2021, and investor reception of these has been relatively positive as most promise significant synergy capture and greater economies of scale. Transactions in which the consideration reflects a premium on the unaffected stock price prior to signing continue to be met with scepticism by investors, while transactions in which the consideration reflects no or a low premium on the unaffected stock price prior to signing have been received more positively. Strategic deals in 2022 included: Southwestern Energy Company's acquisition of Indigo Natural Resources LLC in a cash and stock transaction (upstream); the merger of Cimarex Energy Co and Cabot Oil & Gas Corp in an all-stock transaction (upstream); Crestwood Equity Partners LP's acquisition of Oasis Midstream Partners LP in an all-stock transaction (midstream); and Noble Corporation's merger with The Drilling Company of 1972 in a primarily all-stock transaction (services).

ii Power and utilities

Financial sponsors have led the power and utilities M&A space in 2022 in terms of deal volume; this is due in large part to the IIF's US\$7.8 billion privatisation of South Jersey Industries, Inc, by tender offer. A dominant theme among transactions by financial sponsors in 2022 has been growth equity investments in clean energy companies to enable continued operations and development of clean energy asset portfolios. The following transactions illustrate this trend: Blackstone Infrastructure Partners' US\$3 billion investment into Invenergy Renewables; TPG Rise Climate's US\$750 million investment in Intersect Power, LLC; Ares Management's US\$600 million investment into SB Energy Corp; and EIG Global Energy Partners' US\$400 million investment in 8minute Solar Energy.

Strategic market participants have also been active in the power and utilities M&A space in 2022. In some of the largest strategic acquisitions in this space, strategic buyers have sought out companies with both existing renewable energy generation capacity and large renewable energy projects in their development pipelines. RWE's purchase of ConEd for US\$6.8 billion is an example of this type of transaction. At the time of the transaction, ConEd had 7GW of renewable energy capacity in its pipeline.¹³ TotalEnergies' acquisition of a 50 per cent stake in

13 'Germany's RWE buys Con Edison clean energy in \$6.8 billion U.S. shift', Reuters, <https://www.reuters.com/markets/deals/germanys-rwe-buys-con-edison-renewable-portfolio-68-billion-2022-10-01/>.

Clearway Energy Group for US\$1.6 billion is another example.¹⁴ Financial sponsors have also made investments for similar reasons: Brookfield Renewable Partners' acquisition of Scout Clean Energy LLC for US\$1 billion, Standard Solar, Inc for US\$540 million and Urban Grid for US\$650 million are all examples.¹⁵ In Brookfield Renewable Partners' transactions, the acquisition targets had a total renewable energy generation capacity of over 44GW in their combined development pipelines.¹⁶

At the time of writing, the number of special purpose acquisition company (SPAC) initial public offerings (IPOs) has dropped significantly in 2022 compared with 2021 and 2020. The SPAC IPO market began slowing down towards the end of 2021 and into 2022, in part because of uncertainty caused by the increased focus of the Securities Exchange Commission (SEC) on SPAC activity. The SEC has approved proposed rules and received public comments that would increase regulatory scrutiny of SPAC transactions. However, some market observers believe that, if adopted, the proposed rules would provide necessary guardrails to protect investors and result in increased investment in energy transition-focused SPACs.¹⁷ Since 2020, there have been over 900 SPAC IPOs, over half of which are still searching for acquisition targets.¹⁸ A significant number of SPACs have identified clean energy, alternative energy, climate change, energy transition, ESG, sustainability or some combination of the foregoing as their focus.¹⁹ This may contribute to US power and utilities dealmaking over the next few years as these SPACs look for targets.

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 and utilities) are regulated at both 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 also subject to antitrust laws, as discussed in Section VIII.

14 'TotalEnergies to buy 50% stake in Clearway Energy for \$1.6bn', Power Technology, <https://www.power-technology.com/news/totalenergies-clearway-energy/>.

15 'Brookfield to invest up to \$2 billion in Scout Clean Energy and Standard Solar', Brookfield, <https://bep.brookfield.com/press-releases/bep/brookfield-invest-2-billion-scout-clean-energy-and-standard-solar>; 'Brookfield Renewable Acquires Premier Renewable Developer Urban Grid, Adding Approximately 20,000 Megawatts of Solar and Energy Storage Projects in the U.S.', Brookfield Renewable Partners, <https://bep.brookfield.com/press-releases/bep/brookfield-renewable-acquires-premier-renewable-developer-urban-grid-adding>.

16 *ibid.*

17 'US SEC rules to boost energy transition SPACs volumes', S&P Global, <https://cleanenergynews.ihsmarkit.com/research-analysis/us-sec-rules-to-boost-energy-transition-spacs-volumes.html>.

18 'SPEC Statistics', SPACInsider, <https://spacinsider.com/stats/>.

19 'SPACs Are Also Focusing on ESG Companies', Nasdaq, <https://www.nasdaq.com/articles/spacs-are-also-focusing-on-esg-companies-2021-05-24>.

The energy regulatory frameworks applicable to energy M&A activities vary between upstream oil and gas exploration and production (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 those 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 or products pipeline regulated by the Federal Energy Regulatory Commission (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, liquefied natural gas (LNG) or oil can also trigger regulatory regimes administered by the US Department of Energy (DOE), the Maritime 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, the 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 federal and state level, 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 consumers against potential adverse rate impacts that could result from the transaction.

IV CROSS-BORDER TRANSACTIONS AND FOREIGN INVESTMENT

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee authorised to review certain foreign investment activity in the United States and assess and mitigate any associated national security risks. CFIUS' authority is codified within Section 721 of the Defense Production Act of 1950, as amended, and as implemented by Executive Order 11858, as amended, and the regulations at Chapter VIII of Title 31 of the Code of Federal Regulations. While the CFIUS review process historically has been, and largely remains, voluntary, recent reforms that were fully implemented in 2020 include a mandatory filing requirement for certain transactions that involve 'critical technologies' or a foreign government-controlled investor.

Thus, M&A activity in the energy industry can now potentially trigger a mandatory filing obligation with CFIUS. Failure to submit mandatory filings with CFIUS can result in significant penalties (up to the total transaction value, for each transaction party). Increased technical due diligence is required to determine whether (1) the US target company is involved with critical technologies, 'covered investment critical infrastructure' or 'sensitive personal data' that could trigger a mandatory filing or (2) a voluntary filing may be warranted. Among other things, this determination requires a detailed understanding of the US business's CFIUS risk profile, including the specific export control classifications applicable to each of the US target's products (even if the products are not exported outside the United States). While critical technologies are defined to include the more obviously defence-related articles controlled under the International Traffic in Arms Regulations, they also include a range of more ubiquitous dual-use items subject to certain export controls under the Export Administration Regulations, as well as certain equipment, facilities, parts and components, materials and technology relating to nuclear and atomic energy activities.

Even without a mandatory filing obligation, however, M&A participants often decide to submit a transaction for CFIUS review voluntarily to obtain CFIUS approval, because approval provides transaction parties with a safe harbour from future adverse action from CFIUS and the President in respect of the transaction reviewed. If parties to a transaction subject to CFIUS' jurisdiction decide not to file voluntarily, CFIUS forever retains the authority to initiate a review and take remedial action to address any perceived national security risks (e.g., impose onerous mitigation measures or recommend a post-close divestment order from the President). Recently, CFIUS has dedicated significant resources to identifying non-notified transactions, establishing a new Monitoring & Enforcement division to monitor investment activity; the DOE is a key member of CFIUS, and has been actively involved in reviewing M&A activity in the energy sector that has not been previously submitted for a voluntary review. In 2020, the number of non-notified transactions 'called in' by CFIUS was double the amount from 2019 and 2018 combined, and continued to increase in 2021, with 135 transactions receiving non-notified outreach.

While protecting critical technologies remains a key focus, CFIUS also remains committed to identifying concerns posed by foreign investment in US target companies in close proximity to sensitive US infrastructure, including ports, government facilities and military training bases. This, combined with CFIUS' recently expanded jurisdiction to review

certain real estate transactions by foreign persons, poses unique challenges to M&A activity in the energy sector that involve large parcels of land (e.g., mining, exploration, and solar and wind farms). Further, addressing these types of concerns has broad bipartisan support, which has not receded even with a change in the executive administration of CFIUS. Notably, on 15 September 2022, President Biden issued the first-ever executive order (EO) addressing the risk factors that CFIUS should consider when reviewing a transaction.²⁰ While the EO does not change the scope of CFIUS' legal authority, it provides guidance to market participants on the national security priorities that CFIUS will consider in its reviews, including, among other things, transactions involving, or having a nexus with, energy transition technologies, as well as critical energy infrastructure (e.g., smart grids). M&A participants in the energy industry must account for this heightened and expanded scrutiny from CFIUS, as it affects all aspects of dealmaking from buy- and sell-side due diligence to deal timing and closing certainty more generally.

V FINANCING

Following the disruption to the syndicated loan market caused by the covid-19 pandemic, the US loan market significantly recovered in 2021.²¹ Total syndicated lending reached US\$3.2 trillion in 2021, up from US\$1.5 trillion in 2020.²² M&A lending was no exception: total M&A loan volume reached US\$395 billion in 2021, up from US\$193 billion in 2020.²³

Private infrastructure investments continued to grow in 2021. Infrastructure fundraising saw a record US\$109.23 billion in total annual fund capital raised.²⁴ Infrastructure fundraising during the second quarter of 2022 has pushed the year into record territory, with six months left to go.²⁵ Renewable energy sources continue to be a large focus of infrastructure investments, along with sustainability-linked loans that incorporate ESG targets.²⁶

Although attractive financing was available to borrowers and private equity sponsors in 2021, and loan terms were generally favourable to borrowers, the legal technology underlying some of the debt investments in infrastructure assets still remains antiquated and

20 'Executive Order on Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States', The White House, <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/09/15/executive-order-on-ensuring-robust-consideration-of-evolving-national-security-risks-by-the-committee-on-foreign-investment-in-the-united-states/>.

21 'What's Market: 2021 Year-End Trends in Large Cap and Middle Market Loan Terms', Practical Law Finance (February 28, 2022), <https://us.practicallaw.thomsonreuters.com/w-034-0874>.

22 'What's Market: 2021 Year-End Trends in Large Cap and Middle Market Loan Terms', Practical Law Finance (February 28, 2022), <https://us.practicallaw.thomsonreuters.com/w-034-0874>.

23 'What's Market: 2021 Year-End Trends in Large Cap and Middle Market Loan Terms', Practical Law Finance (February 28, 2022), <https://us.practicallaw.thomsonreuters.com/w-034-0874>.

24 'Fundraising Report 2021: Full Steam Ahead', Inframation (January 18, 2022), <https://www.inframationnews.com/analysis/9907566/fundraising-report-2021-full-steam-ahead.html>.

25 '2Q22 Fundraising Report: Records Shattered, But Slowdown Seen', Inframation (July 19, 2022), <https://www.inframationnews.com/analysis/11950836/2q22-fundraising-report-records-shattered-but-slowdown-seen.html>.

26 'What's Market: 2021 Year-End Trends in Large Cap and Middle Market Loan Terms', Practical Law Finance (February 28, 2022), <https://us.practicallaw.thomsonreuters.com/w-034-0874>.

needs to be updated, including by incorporating elements of leveraged finance to provide additional flexibility. Great progress has been made by sponsor counsel already, but the trend should continue.

VI DUE DILIGENCE

i Overview

In connection with the acquisition of energy assets, there are various due diligence work streams that must be completed, including financial, operations and legal due diligence. Although these work streams often overlap and require interaction between various specialists, this section 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 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 include reviewing title to oil and gas properties (whether in fee or in leasehold interests) and conducting appropriate environmental diligence, as described further in Section VI.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 or make minimum payments 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. The purchaser should also evaluate the creditworthiness of the applicable upstream counterparties to obtain relative comfort surrounding any long-term dedications.

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 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 Section VI.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 by a target company, securities filings (for public companies), and environmental permit transfer and change-of-control requirements (especially for asset transactions);
- c* searches of public environmental databases and news and litigation sources;
- d* interviews with company environmental personnel;
- e* analysis of the relevant environmental regulatory framework impacting on the target company's operations and anticipated changes to the same; and
- f* 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's properties, facilities and personnel 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 (i.e., review of written and spoken records only).

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 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, the asset impacted by the defect is excluded from the transaction or the seller indemnifies the buyer for the defect). 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 and value environmental defects. This 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 without the seller's prior consent), but the buyer often has the right to exclude properties from the transaction if a Phase II is warranted and consent is not granted from the seller. 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 pursuant to the terms of the agreement.

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 (or the value of) environmental attributes (including emission credits), environmental obligations under consent decrees with regulators, environmental and toxic tort legacy liabilities, planned or anticipated capital

expenditures (e.g., for environmental 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.

Another key area of focus for buyers (whether considering growth equity investments or strategic transactions) is the applicability of tax credits (passed into law by the IRA) to renewable energy projects in the development pipeline of the target business. Tax and regulatory specialists should be engaged to conduct an in-depth review of the value created by such tax credits as key economic deal drivers in the renewables M&A space.

Development projects

Key focus areas for development assets include environmental permitting (including permits required to generate environmental attributes), a National Environmental Policy Act (NEPA, or state equivalent) review of projects on public lands or of portions of projects requiring a federal permit (e.g., Clean Water Act Section 404 permit), lender liability protections for environmental conditions at the project site, access to water supply and waste disposal services, and third-party challenges to the project (such as appeals of issued environmental permits). Assistance of local counsel in the jurisdiction where the project is located is often 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 and climate resiliency review

Partly because of increasing interest in sustainable investment by investors, regulators and other stakeholders, more M&A practitioners are considering ESG factors, including projected 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 to the transaction, developing an appropriate scope and work product, and integrating the review into other due diligence work streams. In addition, certain parties are conducting ESG diligence on assets that may be exposed to physical climate risks, such as wildfires, hurricanes, flooding, and extreme heat. Such reviews are typically conducted with the assistance of a third-party consultant.

VII PURCHASE AGREEMENTS AND DOCUMENTATION

Recent developments affect the way parties in the United States negotiate 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 because 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. The variations of a title and environmental defect mechanism are virtually unlimited, and provisions of this kind 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 environmental 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 can 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 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 and satisfaction of escheatment obligations;
- i* suspense amounts or imbalances;
- j* compliance with laws;
- k* no previous transfers of interests outside the target depth or depths; and
- l* accuracy of lease operating statements.

A buyer will typically have the right to terminate a PSA in the event that the seller materially breaches a representation or warranty as of the closing, but the actual 'bring down' standard is often heavily negotiated (e.g., material adverse effect (MAE), quantified MAE, material breach). In addition, to the extent that 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 were able to require that a seller

retain liabilities associated with known environmental matters and offsite waste disposal liabilities, mispayment of royalties prior to the effective time, specified litigation, taxes and excluded assets.

ii Power and utilities

Understanding the regulatory landscape

Antitrust regulatory considerations under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act) are relevant to acquisitions and divestures in the power and utilities sector, as discussed in Section VIII. However, the nature of power and utilities assets poses additional regulatory complexities that are critical to assessing deal execution risk and closing certainty.

Because of the regulated nature 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 because of 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 often seek risk-of-loss provisions addressing casualty and condemnation 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 be likely to 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 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 either to eliminate these additional adjustments or to 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 most recent 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 (see Section VIII.i); covenants should be consistent with the historical ordinary course of the seller’s operation 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 continuing to avail 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) and other M&A insurance products. As described in more detail in Section IX, most M&A practitioners in the power and utilities and oil and gas sectors will require these insurance products in transactions as an additional tool to help eliminate transaction risk.

VIII KEY REGULATORY ISSUES

i Competition

All M&A transactions, including energy transactions, are subject to antitrust laws prohibiting mergers that may substantially lessen competition. For most deals valued at more than US\$101 million,²⁷ the HSR Act requires parties to submit pre-merger filings to the Department of Justice (DOJ) and the Federal Trade Commission (FTC) and observe

²⁷ The threshold is adjusted annually. It was set at US\$101 million in February 2022 and will be adjusted again in early 2023.

a pre-closing waiting period.²⁸ The waiting period allows the DOJ and the FTC to assess the likely competitive effects of the deal and decide whether an extended investigation (a 'second request'), or eventually a challenge on antitrust grounds, is warranted. Until the waiting period has expired, the parties must continue to compete independently and refrain from integrating any of their operations or otherwise behaving as though the merger has been completed (which, when done prematurely, is known as 'gun-jumping'). The rules governing exactly which transactions require an HSR filing are complicated and fact-specific; for instance, certain exemptions apply to the acquisition of some types of upstream carbon-based mineral assets. The HSR waiting period rules apply equally to all reportable deals, regardless of whether they present substantive antitrust concerns.

To determine whether a potential transaction is likely to harm competition, the reviewing agency considers numerous case-specific factors. The agencies often begin by defining relevant product and geographical markets, identifying participants in those markets, and analysing how the proposed transaction would affect competition in each relevant market. The agencies will oppose a deal if they conclude (after an extensive investigation) that it may substantially lessen competition and thereby lead to higher prices or reduced quality, innovation, or output. When the agencies oppose a deal, the parties may enter into a negotiated settlement with the agency to remedy the perceived potential for harm to competition. Such settlements typically require the divestiture of assets, although occasionally they have been limited to restrictions on the post-closing conduct of the merged firm (such as the imposition of information firewalls or assurances of continued supply to a competitor of one of the parties); however, Biden administration regulators are deeply sceptical of such behavioural remedies. Parties also may terminate or restructure proposed transactions in the face of agency concerns. In the small minority of cases in which agency opposition to a deal does not lead to a negotiated settlement, termination, or restructuring, the agency may attempt to block the deal by seeking an injunction in court.

While both the DOJ and the FTC have the statutory authority to investigate mergers, only one agency or the other may proceed to investigate any particular deal. Historically, the FTC has reviewed oil and gas deals and coal transactions, while the DOJ has focused on oilfield services and power generation. State attorneys general also occasionally investigate mergers, either in concert with or independently of the DOJ and the FTC.

Biden administration antitrust regulators at the FTC and the DOJ have adopted an aggressive posture across the board and some observers expected an uptick in attention to the oil and gas sector. To date, agency enforcement activity has been generally consistent with past practice: only a handful of oil and gas transactions have been challenged, all on traditional grounds. Notably, however, one of the challenges related to an upstream deal, and a few other upstream transactions were reportedly subject to meaningful investigations that, to date, have not resulted in remedies, abandoned deals or FTC legal challenges. This attention to the upstream sector is noteworthy because pure upstream deals are typically unlikely to be anticompetitive, as individual companies hold small shares of reserves and

28 The initial statutory waiting period is 30 days. It may be extended significantly in the event of an in-depth agency investigation. Regulations allow the Department of Justice (DOJ) and the Federal Trade Commission (FTC) to terminate the waiting period more quickly at the request of the merging parties if the agencies are satisfied that the deal does not present competition concerns. However, in February 2021, the FTC and the DOJ announced they were 'temporarily' suspending grants of early termination and have not reinstated the practice.

production globally (or in any other relevant geographical market). The still-developing record is consistent with the view that regulators have a more sceptical attitude towards the oil and gas sector than under previous administrations, particularly with regard to upstream transactions, but are continuing to review each deal on its own merits, with the large majority of deals facing no headwinds. Parties to transactions with competitors should be prepared for questions from the FTC, and deals raising meaningful competition concerns can expect lengthy investigations and significant headwinds.

Prior to 2022, the most recent upstream deal subject to enforcement was the 2000 merger of BP Amoco and ARCO, then the two leading producers on the North Slope of Alaska. Along with various downstream theories of harm, the FTC alleged that the deal would reduce competition in the sale of North Slope oil to certain refiners that could not readily shift to other sources of supply. In 2022, the FTC similarly alleged that the merger of EnCap (Verdun) and EP Energy, both significant producers in Utah, would lessen competition because few refiners are optimised to process Uinta Basin waxy crude. Both the 2000 and the 2022 matters were resolved by settlements requiring the divestiture of assets.

In the midstream sector, the FTC defines product markets by focusing on a specific petroleum product transported, refined or stored in a particular way. The FTC has taken enforcement action when customers for a particular product in a particular region would be left with few competitive options. For instance, the FTC required divestitures in June 2022 with respect to Buckeye Partners' acquisition of Magellan Midstream Partners, which would have led to highly concentrated markets for gasoline terminaling in three cities. Similarly, in July 2021, Berkshire Hathaway's Kern River Gas Transmission Company terminated its proposed acquisition of Dominion Energy Questar Pipeline after an investigation by the FTC and the Utah Attorney General's Office. The transaction would have combined the only two pipelines that bring natural gas from the Rocky Mountain production basins to serve central Utah. The FTC also objected on similar grounds to the proposed 2016 merger of Energy Transfer Equity and Williams Companies and the 2015 combination of Par Petroleum with Mid Pac Petroleum. Finally, the agencies may take issue with non-controlling acquisitions, as demonstrated by the FTC's objection in 2007 to a proposed minority investment in Kinder Morgan by investors that also held a 50 per cent interest in Magellan Midstream, which competed with various Kinder Morgan terminaling operations.²⁹ The investors obtained FTC approval for the proposed investment without a divestiture of assets by agreeing both to erect information firewalls between the companies (ensuring no competitively sensitive information would be exchanged) and not to appoint board members to Magellan Midstream (ensuring they could not direct it to compete less vigorously).

Further downstream, the FTC regularly requires divestitures of select gas stations in mergers of gasoline retailers that would leave few independent competitors in narrow local areas. Recent examples include *Global Partners/Wheels* (2022), *7-Eleven /Marathon Petroleum* (2021), *Casey's General Stores/Bucky's* (2021), *Tri Star Energy/Hollingsworth Oil* (2020) (in which the parties divested only two gas stations, demonstrating the FTC's readiness to act against deals with even a small anticompetitive impact), *Express Mart/Speedway* (2019) and *Alimentation Couche-Tard/Holiday Companies* (2018). The FTC also fined Couche-Tard US\$3.5 million in 2020 for violating the settlement by failing to divest the gas stations in

29 The *ETE/Williams* matter referenced above also concerned a combination of non-controlling interests, although, in that case, the parties each held 50 per cent of the relevant assets, whereas in the case of Kinder Morgan, the parties held 50 per cent of one asset and proposed to buy a minority of the other asset.

timely fashion, failing to maintain their viability pre-sale and failing to provide accurate information about its efforts to comply with the settlement. Finally, in August 2022, the FTC required Arko and Corrigan Oil to restructure their closed sale of gas stations (which was not HSR-reportable) to eliminate a geographically overbroad non-compete agreement, one that prohibited the seller from competing with the buyer in areas far from the gas stations that were sold.

In the coal sector, in 2020 the FTC sued to block a proposed JV combining certain thermal coal operations of Arch Coal and Peabody Energy, alleging that it would lessen competition in the sale of coal mined in one particular region (the Southern Powder River Basin) characterised by certain unique properties. The court found that this coal was a relevant market, rejecting the parties' argument that the pricing power of the JV would be constrained by the availability of other types of coal to power producers as well as other types of power generation. After the court granted the FTC a preliminary injunction blocking the JV, pending a full trial on the merits, the parties abandoned the proposed transaction.

The DOJ has been active in the oilfield services segment in recent years, investigating such transactions as *Bristow/Era* (offshore helicopter services), *Ensco/Rowan* (now Valaris) (offshore drilling) and Schlumberger's proposed OneStim JV with Weatherford (onshore hydraulic fracturing). The DOJ also rejected a proposed settlement in *Halliburton/Baker Hughes* (2016), leading to the abandonment of that transaction, and required a divestiture in the subsequent purchase of Baker Hughes by GE (2017). In the proposed Halliburton deal, the DOJ alleged that the transaction would lessen competition in 23 separate narrowly defined product and service markets, mostly relating to offshore drilling and production, such as fixed cutter drill bits, offshore directional drilling, offshore surface data logging services, cased whole wireline services for rigs in deepwater, and many more. The DOJ rejected the proposed divestiture package, claiming it would not fully and successfully replicate competition because it did not include full business units, withheld many critical assets and personnel, and involved numerous ongoing entanglements between the parties and the divestiture buyer. In the subsequent sale of Baker Hughes to GE, the DOJ alleged that the merger would combine two of the leading providers of refinery process chemicals and services and required the divestiture of the relevant GE division.

In the power sector, the DOJ's most recent merger enforcement action concerned *Exelon/Constellation Energy* (2011). Although the parties' combined market share in the sale of wholesale electricity would have been less than 30 per cent in the relevant region, the DOJ alleged that because of the unique competitive dynamics of the wholesale electricity market, Exelon would find it profitable to withhold output and raise prices. The DOJ cleared the deal pursuant to a settlement requiring the divestiture of three power plants. Additionally, in 2017 the DOJ sued Duke Energy in a rare stand-alone action for gun-jumping in connection with Duke's acquisition of a power plant. The DOJ alleged that before the parties made their HSR filings (let alone before the HSR waiting period expired), the parties entered into a tolling agreement under which Duke made competitive decisions for the plant, such that it ceased to compete independently in violation of the rules on gun-jumping. This effect of the tolling agreement allowed the parties to argue to FERC that Duke already controlled the plant, and thereby to bypass an additional level of scrutiny that FERC applies to acquisitions increasing market concentration beyond a certain threshold; this apparently calculated violation of the gun-jumping rules is likely to have contributed to the DOJ's decision to take action. Duke agreed to resolve the DOJ's lawsuit by paying a US\$600,000 civil penalty.

ii Environmental protection

Since President Biden took office in January 2021, the administration has largely reversed the Trump administration's deregulatory agenda by directing numerous federal agencies to revise and strengthen environmental regulations. The Biden administration has particularly focused on regulating oil and gas development on federal lands and waters, curbing methane emissions from oil and gas sources and incentivising development of energy transition projects. The IRA sets aside funding to increase environmental justice funding; curb methane and other emissions with incentives and fees; speed carbon capture, utilisation and storage; improve the efficiency of federal review and permitting; and otherwise accelerate the development of renewable energy sources and low-carbon technologies in line with President Biden's stated target to cut greenhouse gas emissions by 50 to 52 per cent from 2005 levels by 2030.

At the state level, certain states have recently increased environmental protection regulations applicable to the energy industry and taken proactive steps to address projected climate change impacts. Most notably on oil and gas production, Colorado Senate Bill 19-181, which was signed into law in April 2019, expanded local government control over oil and gas development in the state, elevated environmental, health and safety considerations in permitting decisions, and altered pooling, drilling and permitting requirements to be less favourable to industry. Similarly, in California, AB 1057, signed into law in October 2019, specified that the purposes of provisions relating to oil and gas conservation in the state include protecting public health and safety and environmental quality. Recent years have also seen the expansion of greenhouse gas 'cap and trade' programmes, with states including New Jersey and Virginia joining the Regional Greenhouse Gas Initiative and Pennsylvania taking steps to join. In addition to state action, recent court decisions have trended towards requiring federal agencies to consider climate-related risks and environmental justice considerations when reviewing energy projects (e.g., interstate pipelines, oil and gas leases on public lands, electric transmission lines) under NEPA. The White House Council on Environmental Quality (CEQ) issued a rule in July 2020 revising NEPA's implementing regulations and streamlining environmental reviews for such projects. However, in October 2021, the Biden administration initiated processes to review and revise the 2020 rule with a view towards strengthening the review process, including a particular focus on climate change and environmental justice issues. In April 2022, CEQ issued a final rule that reaffirms that a NEPA review must evaluate all relevant environmental impacts, including those relating to climate change and environmental justice.

iii Health and safety

On the health and safety front, under an Occupational Safety and Health Administration standard limiting respirable silica exposure that came into effect on 23 June 2018, the oil and gas industry was required to implement engineering controls and work practices to limit exposures to levels 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 knowledge of both the tax rules and the industry.

The Tax Cuts and Jobs Act (TCJA), which was enacted in 2017, impacted on M&A transactions, primarily through the enactment of 100 per cent expensing (bonus depreciation) for certain tangible assets. These expensing rules apply to the 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; however, it is often challenging to monetise bonus depreciation given constraints in the tax equity market. 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.

The IRA significantly increased the tax incentives available for renewable energy projects, including solar, wind, hydrogen, battery storage, carbon sequestration and certain biofuels. Below are some of the key highlights from the IRA.

Solar and wind assets are eligible for an investment tax credit (ITC) equal to 30 per cent of the ITC eligible costs. Alternatively, solar and wind projects may elect to claim a production tax credit (PTC) for the 10-year period after a project is placed in service. The PTC amount is currently US\$27.50/MWh (as adjusted for inflation). To be eligible for the full amount of these tax credits, certain wage and apprenticeship requirements must be satisfied or the project must be exempt from these requirements (e.g., projects that commence construction no more than 59 days after the Secretary of the Treasury publishes guidance on the wage and apprenticeship requirements). These credits will remain available for projects that begin construction until the end of 2033 or the first calendar year following the year when the Internal Revenue Service determines that the annual greenhouse gas emissions from US electricity production have fallen by at least 75 per cent compared with comparable emissions in 2022. After this point, the credits will begin to phase down. The IRA also extends the ITC to stand-alone energy storage facilities. This new development will allow for significant expansion of storage projects in geographical areas where energy storage is needed for grid reliability.

The IRA also includes a domestic content 'adder' and an energy community adder. The domestic content adder provides that projects that meet certain domestic content requirements may be eligible for an additional 10 per cent ITC (based on eligible costs) or an additional 10 per cent PTC (based on the PTCs generated). Similarly, the energy community adder provides that projects located in certain communities (i.e., historical coal communities, certain brownfield sites and areas with significant employment from coal, oil or natural gas) may be eligible for an additional 10 per cent ITC (based on eligible costs) or an additional 10 per cent PTC (based on the PTCs generated). Therefore, certain renewable energy projects may be eligible for an ITC of up to 50 per cent of the ITC eligible costs.

The significant tax benefits available to renewable energy projects are often monetised through certain tax equity transactions, where a large bank or financial institution invests in a project in exchange for a significant portion of the tax benefits available to the project. There are often significant constraints in the tax equity market and, in an attempt to partly

alleviate this constraint, the IRA introduced a concept of direct pay and transferability. Direct pay is generally available to certain tax-exempt investors investing in certain renewable energy technologies, and transferability is generally available to certain taxable investors investing in certain renewable energy technologies. Direct pay provides for a cash payment in lieu of the tax credits. Transferability provides that taxpayers may sell tax credits to an unrelated party for cash. It is anticipated that these alternative tax credit monetisation options will result in an increase in the number of renewable energy projects being financed without tax equity.

v Anti-money laundering, sanctions and anti-corruption

The primary focus in this space continues to be a dynamic US sanctions landscape and, since February 2022, the conversation has been dominated by sanctions adopted in the wake of Russia's war in Ukraine. The US response to Russia's hostile actions has drawn upon every type of sanction in the US toolkit, plus a few new ones. This response has included the following:

- a* the addition of dozens of high-profile Russian oligarchs and companies to the US Specially Designated Nationals and Blocked Persons List of asset-freeze targets;
- b* a prohibition on US persons engaging in new investment in Russia (including its energy sector) and prohibitions on providing a number of accounting, consulting and related services to certain sectors of the Russian economy;
- c* bans on importing Russian-origin oil and natural gas products to the United States; and
- d* deprivation of the Russian energy sector's access to US financial markets via (1) a prohibition on US persons trading in new debt and equity securities of Russian issuers,³⁰ and (2) extensive use of the above-mentioned list-based sanctions.

The Department of Commerce has also tightened US export controls to prohibit the export and re-export to Russia of a broad swathe of US technology, which has meaningfully impacted on its upstream and midstream activities alike. Additionally, the US State Department has imposed visa and travel bans against hundreds of Russian nationals involved in Russia's unlawful attempts to annex Ukrainian territory.

US sanctions related to Russia implicate the entirety of the value chain. In addition to Russian exploration and production companies, restrictive sanctions target midstream companies, ocean-going vessels and even some lending syndicate members domiciled in the European Union.

The US sanctions-based opposition to Russia's hostile actions in Ukraine has been undertaken in conjunction with and is complementary to similar efforts by the United Kingdom, the European Union and other sovereign states globally. These have included joint efforts to exclude Russian financial institutions from the global bank messaging network, SWIFT, and other similar steps. As reported in the 2021 edition of this book, President Biden agreed in May 2021 to ease sanctions on Russia's Nord Stream 2 pipeline to Germany, seemingly paving the way for its imminent completion in 2022; however, as part

30 Since Russia's annexation of Crimea in 2014, the United States has maintained a sectoral sanctions programme designed to deprive a number of Russian energy companies from access to US financial markets. These programmes remain in place but have been largely superseded by the stricter prohibition on dealing in any new debt and equity instruments from Russian issuers (and many of their non-Russian-domiciled finance subsidiaries).

of its response to Russia's actions in Ukraine, Germany withdrew permission for the pipeline to operate and, at the time of writing, authorities are investigating a series of apparent acts of sabotage against the undersea pipeline.

Lastly, a number of multinational companies have joined the global condemnation of Russia's actions by voluntarily withdrawing from commercial activities on the Russian market, although there do remain lawful, albeit increasingly limited, means to continue to do certain business there. This extra-legal trend towards self-sanctioning complements and in many respects outruns legal measures imposed by the US and other major Western governments.

Other legacy energy sector-related sanctions implicating other countries remain in place, though have been less dynamic in a 2022 dominated by conversations about Russia. For example, with effect from early 2021, the United States imposed a number of measures targeting China National Offshore Oil Corporation (CNOOC), including a prohibition on trade in its public securities by US persons, and a prohibition on the sale of most US goods to CNOOC without an export licence. In addition, US sanctions against Venezuela and its state-owned enterprises have had a continued adverse 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 Petr6leos de Venezuela (PDVSA), 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 (renewed at least through early 2024) to permit its continued access to US counterparties and global financial markets. The sanctions have made for a complex landscape in the secondary trade in PDVSA bonds, with the US temporarily staving off certain bondholders from seeking enforcement against Citgo's US equity and assets.

The United States has shown continued willingness to impose sanctions to discourage third-party companies and vessels from offering material support to certain disfavoured regimes. For example, the United States has targeted with comprehensive sanctions a number of midstream assets (most recently a number of Chinese terminal operators) known to have transported Iranian and Venezuelan oil products.

The existence and complexity of US sanctions underscore the importance of a robust anti-money laundering and due diligence process. This review should include thorough know-your-customer diligence of transaction counterparties, as well as key contractual counterparties of acquisition targets, to identify both extant risk and anticipated exposure to escalating sanctions. Companies entering joint ventures and service contracts are well advised to incorporate termination provisions tied to the future imposition or escalation of US sanctions instead of relying on *force majeure* clauses. Additionally, firms should be mindful that lenders and insurers may apply more cautious risk thresholds when considering participating in a project with sanctions risk exposure, particularly against such a dynamic backdrop.

Finally, inherent corruption risk remains important in the energy sector in much of the world, and it remains a prevalent industry sector for enforcement of the US Foreign Corrupt Practices Act. 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 corruption risk in this sector. While anti-corruption enforcement in this sector is hardly novel, what bears notice is the emergence of meaningful 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, 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 LNG. FERC and the DOE share jurisdiction over the export and import of natural gas and LNG, with the DOE having authority over the 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 infrastructure of this kind, FERC's prior approval is not necessary for such transactions, in the absence of 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 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 power and utility 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 merges or consolidates 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 purchases, leases, or otherwise acquires 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 energy M&A transactions involving power generation assets, the characteristics of the generation asset, the identity of its owner, and the nature of its commercial arrangements all may be relevant to whether FERC's prior authorisation under Section 203 of the Federal Power Act is required. For example, renewable energy generation facilities with certain characteristics may qualify for an exemption under the Public Utility Regulatory Policies Act (PURPA). In one of the more significant developments in the power sector in 2020, FERC overhauled its regulations implementing PURPA, which has created some uncertainty regarding the regulatory status of such facilities and has caused companies that own, or are considering acquiring, such facilities to exercise heightened diligence in assessing associated regulatory requirements.

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 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 licence 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 and utility 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

Energy M&A practitioners, much like those that are industry agnostic, have normalised the use of insurance products to manage representations and warranties (R&W), tax and litigation transaction risk in an effort to maximise sale proceeds for sellers and provide comfort to buyers pursuing opportunities in challenging transactions.

Insurance for R&W and tax has become prevalent in energy M&A transactions as the cost of insurance policies continues to decline and broader coverage terms, particularly

with respect to tax matters, offer more comprehensive coverage for buyers. Market instability during the covid-19 pandemic drove buyers to rely on insurance policies in M&A transactions. However, in 2022, market volatility and geopolitical uncertainty have increased risk in M&A transactions – further motivating transaction participants to use R&W insurance. Energy M&A has become one of the most active sectors in the R&W insurance market as dealmakers seek to reduce transaction risk.³¹

In general, R&W insurance providers in the energy M&A space typically conduct heightened diligence on the condition of assets, environmental as well as health and safety matters, regulatory compliance, customer concentration, cybersecurity, and tax credits.

R&W policies contain standard exclusions. Typically, R&W policies do not cover losses taken into account in purchase price adjustments or specific indemnities in the purchase agreement. Events impacting on macroeconomic activity also shape standard R&W policy exclusions. For example, the conflict between Russia and Ukraine has impacted on the scope of exclusions in R&W policies, with risk stemming from the impact of company operations occurring in Russia or Ukraine typically excluded from standard R&W policies (and only a few underwriters willing to underwrite the risk, most often in businesses that pose no operational risks as a result). Additionally, the covid-19 pandemic has continued to shape how insurance providers in M&A transactions are approaching policy terms and underwriting insurance. Underwriters initially varied their approach to covid-19 generally, although most underwriters are now insisting on broad exclusions of all losses resulting from covid-19. Additionally, because the nature of buyer due diligence and seller disclosure is fundamental to underwriting M&A insurance products, it is now common practice for underwriters' scope of due diligence to cover the impacts of the covid-19 pandemic. That being said, insurance providers continue to tailor their due diligence processes and insurance coverage terms to address access issues faced by buyers and their advisers as a result of the covid-19 pandemic. If a buyer has been unable to address through a due diligence process a specific matter relating to the target arising from health considerations implicated by covid-19, insurance underwriters have, for example, provided for conditional exclusions, in effect postponing effectiveness of coverage for the matter until sufficient due diligence has been completed.

Insurance providers for M&A transactions 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 environmental 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 environmental contamination, continues to be available for coal industry targets from certain US carriers. Pairing a PLL policy with a RWI policy, for example, can facilitate no indemnity deals even for the types of complex environmental risks often attendant in the energy space.

Within the oil and gas M&A sector, R&W insurance availability and use varies depending on whether the transaction occurs upstream, midstream or downstream, or relates to oilfield services. Historically, there has been a lack of R&W insurance coverage for upstream transactions because carriers would exclude title, environmental and asset condition and sufficiency risk from policy coverage. However, as noted above, coverage for environmental risk is becoming more widespread. In the midstream sector, the use of R&W insurance has seen steady increases, but, during the due diligence process, providers will often

31 See, 'M&A Risk in Review 1H', 2022, AON, <https://www.aon.com/m-and-a-riskinreview/global2022-1h>.

conduct heightened diligence on risks related to the condition of assets, title, and material contracts bearing the underwriting risk. For transactions involving downstream refineries, R&W insurance providers have indicated that policies are handled similarly to those for midstream assets, with a particular focus on environmental liabilities. Finally, for transactions involving oilfield services, R&W insurance is standard; however, heightened due diligence is conducted on professional liability risk stemming from workplace injury.

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 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.

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.³²

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 chief executive officer 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.³³

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 on merger litigation

Governing law and forum selection clauses

Of the deal terms that can impact on 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 be governed by the law of a specific jurisdiction. Certain jurisdictions, such as Delaware 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 jurisdictions.

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 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

32 *Akorn, Inc v. Fresenius KABI AG*, CA No. 2018-0300-JTL, 2018 WL 4719347, *62 (Del Ch, 1 October 2018), *affd*, 198 A.3d 724 (Table) (Del 2018).

33 *GreenStar IH Rep, LLC v. Tutor Perini Corp*, CA No. 12885–VCS, 2017 WL 5035567, *7 (Del Ch, 31 October 2017), *affd*, 186 A.3d 799 (Table) (Del 2018). *See also B&C Holdings, Inc v. Temperature Holdings, LLC*, CA No. N19C-02-105, 2020 WL 1972855, at *1 (Del Super Ct, 22 April 2020), *affd*, 247 A.3d 686 (Del 2021) (enforcing earnout provision on similar facts).

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 because of 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 optimistic about 2023. Fundamentals have improved considerably in respect of commodity prices and the overall economic outlook is generally positive. As a result, we would expect generally improving balance sheets, greater shareholder returns and accelerated M&A activity. Headwinds will include:

- a* the risk of recession;
- b* geopolitical issues, particularly those involving China;
- c* negative associations stemming from ESG issues at oil and gas companies;
- d* possible significant cost inflation as the industry deals with overall inflationary pressures in the United States;
- e* the risk of a more stringent regulatory environment and overall negative sentiment towards the industry coming out of Washington, DC;
- f* continued concerns about the ability to generate long-term free cash flow for return to shareholders; and
- g* carry-over negative reputational issues arising out of the past few years of underperformance.

Many strategic deals will get done at low or no premium to the unaffected stock price immediately prior to announcement and, in a departure from recent years, large premium strategic transactions may increase in 2023. Momentum for asset-level deals is likely to continue to increase. Federal and state concerns stemming from ESG issues will continue.

The equity and debt capital markets are likely to remain open for many oil and gas companies. Investors continue to look 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 should be able to satisfy investors' concerns in these areas. Private equity companies will continue to serve as a source of alternative financing through the use of innovative deal structures. Overall, the health of the oil and gas industry should continue improving in 2023.

ii Power and utilities

Dealmakers and market observers in the US power and utilities sector are generally optimistic that, relative to other sectors, M&A activity will continue to increase in the years to come. The positive outlook expressed by power and utilities industry participants is likely attributable to the broader transition towards a decarbonised economy by the private and public sectors, the prevalence of ESG as a fundamental thesis for dealmakers, and increasing demand for exposure to renewables and other clean energy assets by stakeholders and the public at large.³⁴

However, at the time of writing, certain factors indicate that there may be a continued slowdown in M&A activity in the near term, during the second half of 2022 compared with 2021.³⁵ Prospective market participants face challenges from higher interest rates and concerns that the economy may be entering a recession. Nevertheless, financial sponsors and public companies, motivated by ESG goals and pressures to invest in renewable energy, hold an abundance of capital ready to be deployed as favourable opportunities in the market arise and they are, therefore, more optimistic.³⁶ This optimism is also fuelled by tax-based incentives in the IRA, which will continue to drive power and utilities M&A activity in the years to come.

34 M&A Opportunities in the Energy Transition, Bain & Company, <https://www.bain.com/insights/m-and-a-opportunities-in-the-energy-transition-enr-report-2022/>.

35 M&A expected to dampen for remainder of 2022, IFLR, <https://www.iflr.com/article/2acmm88qkkxryzo70r280/m-a-expected-to-dampen-for-remainder-of-2022>.

36 'Deals 2022 midyear outlook', PwC, <https://www.pwc.com/us/en/services/consulting/deals/outlook.html>.

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