Mitigating Risk in a Tumultuous Energy Market

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Mitigating Risk in a Tumultuous Energy Market: Force Majeure, Storage Constraints, Production Shut-ins and Deal Activity

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Speakers:

Steve Davis
sddavis@akingump.com
+1 713.220.5888

Michael Byrd
mbyrd@akingump.com
+1 713.220.2216

Michael Joyce
michael.joyce@akingump.com
+65 6579.9020

Tom McCaffrey
tmccaffrey@akingump.com
+1 713.220.5879

Gabe Procaccini
gprocaccini@akingump.com
+1 713.250.2200

Jim Wetwiska
jwetwiska@akingump.com
+1 713.220.5899

Justin Williams
williamsj@akingump.com
+44 20.7012.9660

Steve: Hi, this is Steve Davis. For technical reasons we had to pre-record the first portion of this program before the dramatic developments in the oil markets yesterday, overnight and continuing this morning. Give us a few seconds to start the recorded portion and we will circle back live shortly. Thank you.

Good morning everyone. I am Steve Davis, a partner in the Houston office. We certainly hope all are well and healthy. We are sure everyone is looking forward to a return to normal, even if it is a new normal. I want to thank all of you for joining us today. These are difficult times for many people and companies, and we appreciate your taking the time to join us. First, some housekeeping details. The audience is on mute to prevent background noise. We will host a Q&A session at the conclusion of the presentations. Please submit your questions as you have them through the chat box feature on the BlueJeans link. Our speakers will address them at the end. We would also like to direct your attention to the articles we included in the reminders sent a couple of hours ago. These pieces are relevant to the topics we will be discussing today. You might also visit the COVID-19 Resource Center on the Akin Gump website. Now please make note of today's CLE code: AG0421. That is AG0421.

So, next I would like to briefly introduce our speakers today and thank them as well. Mike Byrd is the senior upstream M&A partner in our Houston office. Michael Joyce is a partner in our Singapore office and leads our energy practice in Asia. He gets the prize for staying up the latest with the 13-hour time difference from Houston. Tom McCaffrey is a partner in our Houston office who represents private equity investors, portfolio companies and boards of directors in M&A activity and governance issues in both traditional and, importantly today, distressed markets. Gabe Procaccini is a partner in our Houston office who advises integrated energy companies, producers, midstream companies, traders and foreign companies on midstream and downstream transactions and has done so for many years. Jim Wetwiska is the firm's senior U.S. energy litigator based here in Houston and always a source of good information. Justin Williams is a partner in our London office and head of the firm's international arbitration practice.

Let me set the stage just a bit. We all know we are in the middle of a global pandemic and we are involved in a world price war primarily between Saudi Arabia and Russia, but certainly involving U.S. shale producers, who have ramped up production dramatically in recent years. Of course, this is not the

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first time we have seen dramatic shocks in the oil market, but this is certainly a big one. So, let's jump right in. Gabe, we hear a lot about oil storage constraints. Give us an update.

Gabe: Thanks, Steve. As you may know, there is a great deal of concern in the industry right now around the issue of storage or lack thereof primarily for crude oil, but also other petroleum products. While predictions among the various forecasting and market intelligence firms vary, there is a general consensus that the outlook for oil storage has never been more challenging. With oil demand continuing to decline by some estimates anywhere from 20 million barrels per day to 30 million barrels per day, we may soon, by almost any measure, reach maximum storage capacity for oil. Some have indicated that to rebalance the market we would actually need Russia and the Saudis to cut substantially all of their output.

And the threat of reaching maximum storage is impacting the entire oil and gas value chain. The topic has even caught the attention of the Railroad Commission in Texas, which is currently considering, for the first time since 1973, forcing producers to reduce production due to the concern from some in the industry that free market forces alone will not help rebalance the market and solve the storage problem. This dynamic is certainly impacting pricing. For example, prices for physical delivery of crude have recently plunged to some of the lowest levels in decades. While WTI has not broken the all-important $10 per barrel support level, a price we last saw in February 1999 at the start of the great commodities super cycle of the 2000s, local market pricing of late for crude oil has been well below $10 a barrel. We understand that last week Midland Basin barrels were trading at nearly $9 per barrel and Delaware Basin barrels at about $3 per barrel. We also saw prices for certain Canadian grades trade even lower and it has been reported that Wyoming Asphalt Sour, a grade of crude, traded at negative 19 cents per barrel last month, effectively meaning that, at those prices, sellers must pay buyers to take their product.

It is not just crude prices that are feeling the impact of storage constraints and falling demand. For example, in the Utica, condensate has been trading between $0 and a $1.50 per barrel this week. So, storage constraints or expectations of constraints are not just impacting oil producers, but even many gas producers with liquids exposure. While the broader equity markets are up more than 20% on average from their lows last month on expectations of a reopening of the global economy, the crude oil market is not yet showing signs of a sustained rebound, signaling perhaps the worst may be yet to come for oil prices, particularly with U.S. storage options expected to be nearly exhausted in three to four weeks. Over to you, Steve.

Steve: Thank you very much, Gabe. Mike, tell us what you are seeing in the upstream space, especially in the acquisition and divestiture arena?

Mike: Thanks, Steve. Good morning folks. One thing we're seeing is buyers are focusing some of their due diligence on these storage and lease maintenance issues, such as making sure there are firm long term contracts for the seller's production, and really drilling down on the risk of lease terminations due to shut-in or paying quantities issues.

Second, upstream A&D is way down. Last quarter energy was only the 4th largest industry in Texas M&A deals, and that was the first time in 13 years that it wasn't number one. At these prices, no one's putting much value on PDP, and they're not putting any value on undeveloped acreage. It's hard enough to make a profit when the well's already been drilled, much less having to add in the capital cost of drilling new wells. Moreover, even when

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a deal is made, buyers are having trouble getting financing in this environment.

Third, earnout provisions are being used quite a bit to bridge the bid-ask spread. A good example of these last 2 points is the acquisition of Alta Mesa and Kingfisher out of bankruptcy by BCE Mach, where BCE Mach was the high bidder and signed a contract for $320 million that was approved by the bankruptcy court, but they lost their financing when prices collapsed. Then there was a new process and BCE was again the high bidder, but the price dropped by $100 million, and there were 2 separate price adjustment mechanisms, one tied to oil prices on the closing date, and the other tied to oil prices over the first 3 years post-closing. So we're seeing folks looking to do deals if they can "steal" assets at bankruptcy sales because the banks are just trying to salvage whatever they can, but you're also seeing some cases where the banks are just taking over the assets, and looking at putting together management teams to run the companies until things turn around.

Steve: Mike, thank you. It is a difficult time. Tom, please give us a big picture view of what is going on in the energy-focused private equity world?

Tom: First, from a big picture perspective as Mike mentioned, there is not a lot of M&A activity-- not much in the way of strategic activity or private equity generated activity. The severe consequences of the low oil prices and low demand are leading to reduced capex spending, furloughs, layoffs, executive pay cuts and unprofitable drilling programs. As a result, many of the private equity investors are focusing on their existing investments and mapping out their strategies on how to deal with their current investments given the new market dynamics as opposed to chasing new deals. To help with liquidity, many of the private equity investors have advised their companies to draw down on their revolvers and bank loans. The recent cut in oil production by Russia and Saudi Arabia is viewed as helpful, but does not solve the great drop in demand and the problems caused by it.

Another key event that we will see over the next month or so revolves around the redetermination process. Many companies and their private equity investors are anxiously awaiting to see how their redetermination process will play out and how aggressive or passive the lenders will be. This process will likely make or break many companies. Every day we are seeing more and more announcements about companies hiring financial advisors and restructuring counsel. Most people expect a tremendous number of bankruptcies to result from the current climate. There is a lot of uncertainty these days, and it appears that many private equity investors with funds to invest are waiting to see if things will continue to deteriorate before transacting.

Steve: Tom, thank you. That might lead to some opportunity for non-traditional private equity investors to come in, so let's see how that all happens. Michael, Singapore is a long way from the United States but frankly, this is a global energy industry. What are you seeing in the international markets from a big picture perspective?

Michael: Thanks, Steve and hello everyone. Steve, you are right, Singapore is a long way away from the U.S., but it is not so far away from the U.S. in terms of the impact we are seeing on the oil and gas sector. What we are seeing in Asia, the subcontinent and Europe very much mirrors what we are seeing in the U.S. The impact basically falls into three categories: collapsing demand, stress on the supply chains, and then corporate and governmental financial stress due to the first two issues.

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In terms of demand, we have seen very sharp demand drops in Asia, particularly China, which is down around 3 million barrels a day or about 20% of the total consumption that was in March. We expect a similar dramatic fall in Japan and India. For example, in March, Japan's crude imports fell about 10.2% and consumption in India fell by 18%. Similar falls are expected in the rest of Asia and likewise Europe with lockdowns in Italy, Spain, Germany, France and the UK.

In terms of stress on supply chains, the capacity issue that Gabe mentioned has also been playing out in the rest of the world. But, even before the impact of COVID-19 started to be felt globally, the energy sector was already suffering from low oil prices. However, now that situation combined with COVID-19 related storage constraints and the collapse of downstream demand has effectively lead to the destruction of the ability to mitigate through resale. Particularly where take or pay contracts are concerned. In the absence of other contract relief, FM is often the only resort and that is a lot of what we have started to see in the region.

To use LNG as an example, we have seen reports of Chinese, Indian, and Korean LNG importers all claiming force majeure under their LNG purchase agreements. Some commentators also expect Japan to follow suit given the Government's declaration of a state of emergency.

So, all of these reductions, and with essentially no end in sight until maybe mid-June or Q3, has meant severe impacts on oil producer and refinery use and on Government reliant on oil royalties revenues. This leading to significant impairments and reductions in corporate profit forecasts being announced and leading to a lot of financial stress. Lower government revenues from oil and gas production are also putting severe pressure on government budgets at a time where more spending is needed to mitigate the social impacts of the virus. The only bright note that I can see is there are signs that the curve is flattening in parts of Asia and Europe, so hopefully there will be some lifting of the restrictions soon. Thanks, Steve.

Steve: Thanks, Michael. It is definitely a global industry here, and you mentioned force majeure and, of course, that is a key feature of some of the things we are hearing daily from our clients. So, let's investigate that a little bit here. Jim, you are the U.S. senior energy litigator. Tell us about this force majeure creature. What is it and how is it often used?

Jim: Good morning, Steve. I appreciate the opportunity. We have certainly received numerous calls over the past few weeks about force majeure from clients who are trying to trigger force majeure provisions and by clients who are receiving force majeure notices. In a general sense, what contractual force majeure provisions are really intended to deal with events that are outside the reasonable control of the parties. When we talk about force majeure, we are looking at in the context of a contractual provision and it certainly just being an allocation of the risks by temporarily suspending performance that has been made impossible due to circumstances beyond the parties' control and it is a common contractual provision. However, I think that what parties and contracts do not focus enough on is that if you are looking at force majeure, it is critical that you look at the contractual language and you need to focus on what the contract says about the force majeure events.

Generally, we see two things right now. We see contractual provisions that might specifically set out pandemics as a force majeure event and we see many contracts that do not. In those contracts that do not set out that specific event, we are looking at whether or not there were governmental orders or other specific provisions that identify the force majeure event, or if we will

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have to rely on some sort of catchall provision. That requires you to look closely and so what we have been focused on for clients is the specific contract language and whether it provides an event of force majeure and reminding clients that when force majeure does occur it is generally just temporary in nature. It just suspends performance during the time period of that specific event. It does not relieve you from your contractual obligations in the long-term, and I think that is a very important part of this.

Another thing we are focused on is reviewing contractual notice provisions. Make sure that you provide the appropriate notice, as the contract requires, and make sure if you do institute force majeure, that you look at and identify the event and tie it to the contractual language. Those notice provisions are important. I think one of the key takeaways, no matter what side of the force majeure equation you are on, is that you are able to identify the facts of what the contractual provision is and keep in mind it is generally suspended performance. That is what the force majeure is intended to do.

Steve: Jim, thank you. I could not agree more with the comment that we should all be looking more closely at force majeure causes. They are not going to play in the back of the agreement. They are critical provisions and this situation that we are in today will serve to give all of us a reminder of that. Mike and Gabe, let’s look at how force majeure is affecting the upstream and midstream sectors. Mike, you first on upstream.

Mike: First of all, to repeat what Jim said, you need to read the force majeure clause to determine if you actually have a force majeure event under the contract and analyze whether that event is actually preventing performance under the contract. With respect to oil and gas leases, your main concern is avoiding lease termination due to having either no production if you’re shut in, or lack of production in paying quantities. Usually, low commodity prices alone do not qualify as a force majeure event. But if you literally have no ability to deliver your oil because all the storage capacity is full and there is no other market, or if you have a governmental order to shut in production, either of those may qualify depending on the language of the lease. In the case of a governmental order, you have to take into account what the order requires. There is a Texas case where the Railroad Commission ordered a well to be shut in and the court held that this clearly came within the language of the force majeure clause. But let’s say that instead of a shut in order, we have an order that just requires all operators to cut production by X%, say 20%, and then the operator gets to choose where it makes its cuts to avoid issues of lease termination and contract breach. Then I think this could increase the risk of dispute. For example, a lessor may claim that the lessee could have maintained the lease by making larger cuts on other leases or other wells. Such a claim may not be valid but I can see it being asserted and then discovery conducted to assess the merits of the claim. Importantly, even if force majeure does not apply, there are some other lease saving provisions and concepts that may protect the lessee. I am going to highlight those when we get into the next topic.

Steve: Mike, thank you. Gabe, now can you address some of the force majeure issues affecting midstream?

Gabe: Force majeure or the threat of force majeure is certainly affecting the midstream industry and one of the frequent questions I am being asked by clients now is whether force majeure could apply to their midstream activities. In other words, could force majeure provide a potential “escape hatch” from burdensome midstream obligations in this environment? Unfortunately, no one can provide a definitive one-size-fits-all answer to this question because the answer really turns, as Jim and Mike indicated, on the language in the contract. Also, we cannot really be certain if force majeure applies in general because there is little standardization in force majeure definitions and courts will generally apply a strict application of the actual language, so vague force majeure formulations or conflicts among force majeure provisions and other provisions in an agreement will often lead courts to determine that, under the facts and circumstances, a force majeure event did not occur.

And even a blanket declaration by a governmental agency, such as a general force majeure declaration by the Railroad Commission of Texas, or FM certificates, such as the type issued by the Chinese government to certain Chinese buyers back in February, alone will in many cases not be sufficient to give rise to a valid force majeure claim under midstream agreements. So, when confronted by an FM declaration or threat thereof in a midstream contract—and I'll focus on long term supply agreements today—the first line of inquiry should be to analyze the specific event that has been claimed as giving rise to the request for relief. While an FM claim could be asserted on the basis of the occurrence of COVID-19 or on the basis of governmental restraints related to COVID-19, what I think you are more likely to see, and what I am seeing companies consider with their long-term supply contracts, are potential FM claims due to storage constraints. Let's discuss that circumstance. As Jim previously stated, force majeure affords relief from liability to the extent a party is prevented from performing. Thus, in order to declare force majeure due to lack of downstream storage, unless otherwise agreed by the parties in the force majeure clause, entities generally must have an obligation, such as an obligation to store under their supply agreement, which can no longer be performed. Then the question turns to whether the parties have such a storage obligation. Many long-term supply agreements, and for that matter, many other midstream agreements, do not include a storage component. For example, a long-term supply agreement might provide that a marketer has an obligation to purchase a minimum quantity of barrels and perhaps an obligation to market those barrels, but not necessarily an obligation to store those barrels and that is often an important distinction for force majeure analysis purposes.

On the producer's side of the equation in a long-term supply agreement, producers may only have an obligation to deliver and pay, or just pay if they do not have the hydrocarbons available, and not necessarily an obligation to store that would be an obligation that could give rise to a producer-declared force majeure. Thus, if there is no obligation to store in the underlying agreement and a lack of storage is not preventing the parties from performing the activities contemplated under their agreements, for example, buying and selling crude under a supply agreement, then force majeure is likely not going to be available just because downstream storage is full or nearly full—no matter how inconvenient that lack of storage might be, the fact would remain that the parties can still perform the activities contemplated within the "four corners" of their contract.

A quick word, if I may, about demand constraints. Most midstream force majeure provisions expressly exclude market conditions, such as lack of markets or lack of demand or changes in commodity prices, from the list of circumstances that could give rise to a valid force majeure claim. So, if a party is attempting to declare force majeure under a long-term supply agreement due to lack of storage, but the lack of storage is really due to lack of a market, a counterparty seeking to reject such a claim might well look through the claim and argue the cause of the nonperformance is really due to market conditions and thus the claim should be deemed invalid. Back to you, Steve.

Steve: Thank you, Gabe. Indeed, there are some complicated issues here. You mentioned the uncertainty in interpretation of force majeure language. That is why we turn to people like Justin, who is our international arbitration specialist. Justin, what are you seeing internationally, and is there anything particularly different about English law treatment of force majeure issues we should highlight?

Justin: Thanks, Steve. We are seeing a range of issues. We are seeing parties looking into whether their contracts might permit changed or substitute the performance, and also whether there is a way to escape or terminate contracts. But most of the questions at this stage are around force majeure. And on that, the choice of the law is significant. Now, English law on force majeure is in many ways similar to New York law. Both systems adopt a pretty narrow construction of those sorts of mechanisms in terms of permitting parties to suspend performance, but there are differences. Everything depends on the wording of the contract, like Jim said earlier. But in principle, there are differences: for example, many force majeure clauses are structured to include a list of examples of force majeure events. Often, that list is followed by broad catchall language, like “or any other cause beyond the parties’ reasonable control” or something like that. Now, under English law, the preceding list typically does not qualify the catchall wording—the list does not restrict the interpretation of the catchall—whereas under New York law, there is at least some case law supporting a view that the list does qualify it, so that the catchall might only cover events of the same kind or nature. And another difference is that New York law in many cases requires that force majeure events be not foreseeable, whereas under English law there is no such requirement. Therefore, depending on the wording of your clause, in some circumstances it may be that a force majeure clause under English law would be broader than under New York law. Back to you, Steve.

Steve: Justin, thank you very much. We do have many discussions over the years about some of these issues internationally. Let’s turn now to the current state of play and related action items that folks might be able to consider. Tom, let’s start with you. How are private equity investors dealing with portfolio companies that are not performing under their investment and governing documents?

Tom: Thanks, Steve. As you might imagine, the response varies from investor to investor. In addressing credit issues in a portfolio company, I have seen private equity investors effectively waive all the defaults in credit documents where they serve as lenders and provide rescue financing on terms much better than the companies could obtain elsewhere. In my experience, the extent of the rescue financing transactions is often dependent on where the investor participates in the capital structure. For example, some private equity investors may only be in a lender role. In that case, investors may agree to defer interest and principal payments, extend maturities, and/or provide financial covenant relief.

Additionally, I have seen lenders advance new money rescue financing in addition to relaxing the payment terms and the financial covenant levels. Some lenders interestingly will try and structure the new money loan in a manner similar to debtor-in-possession financing in the bankruptcy setting. That is, while there is no immediate bankruptcy risk, the lenders will try and structure the new money financing as super priority in nature with first right to payment and first right to security. And while some private equity investors may only be in a position to hold debt, other investors hold both debt and equity, and because of their multiple positions in the capital structure, these investors have multiple ways to address a distressed situation. For example, in addition to relaxing payment terms and covenant levels, a lender might convert some of its loan to equity. This could be structured in a number of ways, but a simple way would be to have the

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lender convert the loan into whatever class or type of equity currently owned by the lender—just more of it.

Another way could be to structure the converted debt into a preferred equity security. Both of these securities can provide immediate relief for a distressed company and can be tailored to address the specific needs of the company. A fairly typical structure would be for the preferred equity to receive no cash payments for a fixed time period, and provide the company or investor or both with options to convert the preferred equity into common equity. Additionally, it can be structured to provide the company with an option to redeem the newly converted preferred equity sometime in the future when the company is experiencing better economic times or provide the investor with a put under certain circumstances. Those are some of the ways private equity investors are dealing with non-performing investments.

Steve: Tom, thank you. We have seen nothing except a growing complexity in capital structures since last downturn in the 2015-2016 timeframe and certainty that continues. Mike, earlier you alluded to some of the other ways to mitigate lease terminations. Could you talk about that further?

Mike: Yes, the first place I would look is the shut-in royalty clause. In many leases, you can only pay shut-in royalties on gas wells, but in most industry form leases, the clause actually applies to either oil or gas wells. If it does apply to oil wells, then you can hold the lease by making shut-in payments for as long as the lease allows, which is typically at least two years. And shut-in payments are often very small.

Second, most leases also provide that if production ceases from any cause, the lease will not terminate if the lessee commences drilling or working operations within a specified time, and that leads to the restoration of production.

Third, I want to make a couple of brief remarks about production in paying quantities. First, I would suggest it is not reasonable to limit the paying quantities analysis to the months during which we had the greatest imbalance in oil supply and demand in history. Second, for those states like Texas and North Dakota and others that have a second subjective prong of the paying quantities test, I would suggest that the extraordinary events that led to low prices and the need to cut production should certainly be taken into account when evaluating whether a reasonably prudent operator would continue to operate the well.

Fourth, the lessor has a common interest with the lessee in obtaining the highest possible price for production. So, there are many lessors who are willing to enter into amendments to allow the lease to be extended until we get past this, especially where there is a good relationship between the lessor and the operator.

And the last point here is that, in making these decisions as to where to cut production or shut in wells, the company has to balance lease termination risk against economic and engineering risk. In other words, a lease that allows you to shut in could be one where you have greater risk of damaging the reservoir if you do shut in the well. For example, take a waterflood operation, where the operator is balancing the injection and withdrawal and it is on a smooth curve, getting all the oil out. If it suddenly shuts in the field, it will never get it back to the efficient levels it was previously producing. So, these are decisions that truly require input and collaboration between several departments of a company.

Steve: Mike, thank you. Interesting issues indeed. Gabe, you are following these midstream companies particularly closely. What should they be focused on today?

Gabe: Midstream participants should be focused on preparing for the coming onslaught of contract renegotiation requests and should be hyper-focused on finding practical solutions and reasonable compromises to mitigate the risks, which have emerged as a result of this crisis. This is not the time, in my opinion, to necessarily stand firm and risk upsetting long-term midstream relationships over what could be a relatively brief period of dislocation. Moreover, midstream participants should be mindful of the need to address counterparty relationships in a coordinated manner within their business development groups. If you fail to coordinate your responses company-wide, you risk missteps, which could lead to rumors getting out about your renegotiation efforts, and you may then face an avalanche of requests from a greater number of your customers seeking to renegotiate or worse. And business development teams need to make sure they have a deep understanding of the classes of midstream contracts that their companies possess and the potential exposure under each so they can be best positioned to quickly respond to accommodation requests from customers, and also minimize the risk of breach. For example, some midstream agreements might contain a most favored nations provision that could become problematic if a renegotiation response is not coordinated company-wide or midstream agreements may require parties to use commercially reasonable efforts to renegotiate when market conditions change or might contain hardship clauses or price review provisions that create an obligation to dialogue with a counterparty, and companies need to be cognizant of those provisions.

We are already seeing midstream operators be quite proactive in this crisis. Some pipeline and storage operators have been sending letters to producers asking them to be ready to curtail production due to storage constraints or asking that the producers confirm that they have firm commitments to move product downstream of their terminals as midstream companies do not want to be left in a position of trying to find a home for their customers' crude oil that may not exist or may not exist at a price that anyone likes.

I am also seeing a general reluctance by midstream participants, so far at least, to use force majeure threats or an actual force majeure claim as leverage. Beyond the challenges of force majeure previously discussed, there are a couple of other reasons for this. First, because many midstream agreements provide a counterparty the right but not the obligation to terminate for extended force majeure, the declaration of force majeure starts the clock on termination rights. At this time, of course, there is uncertainty regarding how long the crisis continues. For a midstream company financed on the basis of long-term contracts, you would want to be quite mindful about starting the clock too early and increasing the risk you might actually lose customers due to extended force majeure. Second, generally during force majeure, the nonaffected counterparty is relieved of its deliver or pay commitment and can take its hydrocarbons to another marketer on a temporary basis. So, force majeure means potential lost revenue for a midstream company. Third, a force majeure claim often becomes public—therefore, now you must manage a variety of stakeholders in a very public way. I am also seeing efforts by midstream companies to provide notice that if they need to curtail, they will curtail producers on a prorated basis. This makes sense, particularly where you may be able to ratchet down some purchase commitments without liability under certain exclusions that may be embedded in your firm commitment language or better yet, for midstream companies, if the service is proratable. So, in summary, midstream

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companies should continue these efforts and strive to find reasonable solutions. Sometimes those solutions might involve make-up rights, future discounts or extending the term to rebalance the lost economics from this period. Trying to find reasonable compromises in lieu of litigation or force majeure threats is likely the right mindset to possess at this time in this crisis.

Steve: Great, thank you. Let’s look at some key takeaways here. Tom, what about you? Not all oil and gas companies are in significant distress. What planning should private equity investors and companies be doing now, or is it too late to plan?

Tom: Thanks, Steve. First, it is probably not too late. One’s particular planning needs are a function of where you are relative to your investors or investments. What I mean by that is some companies may find themselves in this difficult business environment, with low demand and low commodity prices, but are not in any immediate financial distress. Perhaps they have no near maturities and their redetermination process will be manageable. Companies like that, for example, should look ahead and be proactive and consider some non-financial aspects of their businesses. For example, with respect to a public company, do they have any board vacancies coming up? If so, consider a candidate who has experience in these distressed markets and who has experience dealing with the issues that a company in this environment will eventually face.

Other areas to consider, whether a company is private or public, are their retention policies and their incentives to keep their management teams in place. Some companies may be forced to reduce work forces, but still should examine their policies to make sure that they are positioned to retain the talent they will need to overcome these difficult times.

Another overlooked item is D&O coverage. Examining your policy when not under pressure is the best time and may result in better terms and lower costs.

Disclosure issues for public companies are always important, but sometimes are more of an art, not a science, when determining what to disclose when you are not in immediate financial distress. Similarly, when a company is in a distressed situation, knowing what to disclose can be challenging.

Finally, when not under immediate stress, planning can also involve M&A activity. Some companies are actively seeking to transact in this environment and healthy or even relatively healthy companies may find more receptive ears when talking to targets.

Also, given the market and given their own unique circumstances, some private equity backed companies are not able to count on additional funds from their sponsors and, therefore, are forced to be sellers in a market like today. These situations can provide opportunities.

Steve: Thank you, Tom. Indeed, they can. Gabe, what can you add from a midstream perspective?

Gabe: From a midstream perspective, participants should be focused on the interrelatedness of the global upstream, midstream and downstream sectors today, as the industry is more sensitive to events throughout the global value chain in this era of U.S. crude oil exports, LNG exports and the shale revolution than it has ever been before. Given how oil and gas companies in many cases have elected to participate in greater portions of the global energy value chain—for example, U.S. exploration and

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production companies selling production into international markets or for international prices—many companies now may have more exposure throughout the global value chain than their company profile might otherwise indicate. So, what this all means is, if you are a midstream company evaluating counterparty credit risk or building out your forecasts for growth, it is not enough to just rely upon your customers' drilling or development plans to model that growth. You also need to understand, among other things, your customers' exposure under its other midstream agreements and the risk profile of those other midstream service providers.

And for E&P and others evaluating the risk profile of their midstream service providers, do not assume, of course, that a midstream company has little to no commodity price exposure. Even under fixed pricing contracts, there can be significant commodity price exposure as we have all seen of late. Moreover, understanding a midstream company's exposure under its pipeline joint ventures—and there are many new pipeline joint venture projects under development—or the incentives that may have been granted to producers by a midstream company and the liabilities arising therefrom, or the amount of liquidated damages or liabilities that may have accrued from any failure to timely connect a producers' wells during this crisis, or the allocation of responsibility for treating non-conforming product, or even pipeline abandonment cost exposure—these are all important factors in evaluating a midstream entity's business beyond the gathering or transportation rate or marketing charge that an entity may earn or even the latest trading price of that entity's paper.

Another point is that midstream participants also should be aware that in bankruptcy, midstream contracts may not survive. While there have been some cases which have held that midstream contracts cannot be terminated by a producer in bankruptcy, there are other well-publicized cases where midstream contracts were found to be executory contracts and subject to termination. The analysis here turns in part on the terms and conditions of the applicable midstream agreements, including, for example, the language in the granting clause and dedication and commitment provisions, whether the agreement is drafted as a production or acreage dedication, whether the legal descriptions of the real property interests purportedly being conveyed satisfy the statute of frauds, and whether the lender and/or lessor consents to assign the applicable real property interests were obtained.

Moreover, in this current environment, in some cases, we may have both the midstream service provider and its producer customers in bankruptcy at the same time, and it may turn out that it is not always the producer seeking to terminate its midstream contracts, but midstream companies seeking to terminate producer-friendly midstream contracts because such agreements are no longer economic in this environment, and the producer actually seeking to keep such midstream agreements in place. And the knock-on effect of multiple defaults across the space at nearly the same time should certainly not be underestimated. So, revisiting lessons learned from the industry's experiences in 1986 may be helpful. You remember those days—right, Steve?

Steve: Indeed I do. Jim, how about you? Any further thoughts on force majeure issues?

Jim: Steve, briefly the key takeaway for force majeure is you have to remember that if you are going to claim force majeure, it is your burden to establish it. The decision to claim force majeure should not be taken lightly. We really stress that parties should consider mitigation, looking at alternative performance methods, and doing a thorough analysis before making the leap to claiming force majeure. Keep in mind that under certain

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circumstances, if you do not properly trigger force majeure, or you do not have the basis to do it, that could constitute an anticipatory refutation of the contract and that can lead to a whole host of other problems. We just emphasize that the decision to use force majeure should be taken very seriously. It really requires a thorough analysis of the contract, and a thorough analysis of the force majeure provision itself.

Lastly, the biggest piece of advice here is to be consistent. Whatever position you take on force majeure, make sure you are being consistent within and among all of your contracts and all of your relationships on that position.

Steve: Sage counsel, Jim. Michael, you are the furthest away from the United States, but please bring us home on this segment. What are your key takeaways?

Michael: I will focus on two issues that are more issues for the future. The first is that sellers and buyers need to look closer at diversification to mitigate future risks. Sellers, in order to ensure, for example, that if a lockdown of China event occurs, supply can be made to another jurisdiction to keep revenues flowing. And, for buyers, to ensure that supplies can come from other less impacted jurisdictions to keep their businesses right. I think that more diversification for these companies is something to pay more attention to in the future.

The second point is that, particularly on long-term sales agreements, force majeure and risk mitigant provisions in LNG contracts, like downward quantity tolerance or DQT, scheduling flexibility, cancellation rights, MAC but even potentially price review clauses, will probably need to be looked at in a new way, particularly what does and does not constitute force majeure. For example, in an international context at least, should a buyer really not be able to claim FM if there really is massive demand destruction, inability to take due to storage constraints and inability to mitigate for the same reasons? It is a very seller friendly market in many ways, internationally, for example in LNG, and I would not be surprised at all if this becomes a very, very large issue in new long-term contracts in an international context.

Steve: Thanks everyone for those key takeaways. As we mentioned at the beginning, we had to prerecord part of the program, but we are back live now. As promised, we will now turn back to Mike Byrd for a brief update on the latest deliberations by the Texas Railroad Commission. Mike?

Mike: Actually, the commission is meeting at this very minute about this topic, and Ryan Sitton has been the only one ready to vote today. He has indicated he is ready to vote for a motion today to prorate on an operator basis, not a lease basis, by having a 20% cut to all operators with exclusions for operators producing less than a thousand barrels per day. The other two commissioners are not indicating they are not in favor or prorationing, but they want a little bit more time to make sure that what they do is legal. Also, Christian has indicated they are appointing a task force and will revisit this issue in two weeks at the next meeting on May 5th. More to come today, but that is what is going on at this very moment.

Steve: Thanks, Mike. Using both parts of your brain so you can to listen to one, and then the other. Now in the remaining time that we have we will turn to a few questions. We got one that I think we may have answered, about use of force majeure to avoid lease termination, but let’s just hit that again very quickly. And at the same time, Mike, you might address how to use liens that are present or granted in joint operating agreements to good effect.

Mike: Thanks, Steve. Again, on force majeure, it is going to be a very lease-specific, contract-specific issue, as well as a very fact-specific issue, as I have mentioned. Assuming the force majeure clause applies, you have to consider, do you have a single well? If so, you may be able to rely on the force majeure provision to shut-in that single well. If you have multiple wells and you have some wells that are producing better than others, you may be able to reduce your production, make your cuts elsewhere, without having to shut in the well. In that case, I would be concerned about trying to rely on the force majeure clause to avoid lease termination. I would first look at some of the other lease savings clauses that I mentioned, like shut-in royalties, cessation of production, etc. In addition, on the second question, both whether the operator or the non-operator, you should file a reporting supplement to your operating agreement in the county, and file UCC ones as well with the Secretary of State.

Steve: Mike, thank you. Justin, a question for you. In your experience, what sorts of issues in this environment are most likely to end up in arbitrations, and how can that be avoided?

Justin: Thanks, Steve. I think we are seeing actually good amounts of cooperation at the moment, and I think most issues around force majeure, and so on, will actually be resolved commercially. In my experience, those issues that are most likely to end up in arbitration are where one party tries to misuse a contractual mechanism. For example, we are seeing a number of examples of arbitrations where parties to M&A deals or farmout agreements seek to engineer the conditions precedent to closing are not satisfied as a means to escape the deal. Headline to avoid disputes? My advice is be straight with your counterparty, and to pick up a point Jim made earlier, be careful to operate your contract exactly as it provides.

Steve: Always good advice, Justin. Thank you. Tom, here is a question for you. Some of the fixes you discussed for distressed companies appear to be consensual steps that help a company. What happens if there is not agreement?

Tom: Well, you are right Steve. Sometimes a company is in a super distressed situation where the parties may not be in agreement on how to proceed. In those cases, the consensual tools we talked about may not be enough. I've seen private equity investors take control of a company with a view to affect an exit, a sale of the company or sale of its assets. Pursuing a merger with another company, or even pursuing out-of-court restructuring are options that we see these days.

Steve: Very helpful. So, let's take one more question here and then we will wrap it up so we can keep to the hour. Gabe, name one thing you would do differently in drafting a force majeure clause post COVID-19.

Gabe: Steve, if I am representing a seller, I would want to make clear that in a world of negative pricing—and no one I know ever predicted we would see WTI priced at negative $40 per barrel yesterday—I would want to be darn sure the seller is able to obtain relief, notwithstanding any limitations in the force majeure clause in respect of claims that could be characterized as attributable to market changes or economic performance and thus excluded. So in other words, in a world of negative pricing, as a seller, you may want to be able to access that "escape hatch", to at least suspend sales activities without liability, whether that right is exercised through force majeure or perhaps a material adverse change (MAC) clause, a hardship provision or even under the doctrine of frustration of purpose or other common law remedies. If the "escape hatch" is not addressed in the force majeure provision, and there may be good reasons not to build it into that provision

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depending upon the facts and circumstances, I would want to make certain that the agreement does not provide that the force majeure provision sets forth the sole and exclusive remedy for relief due to supervening events, such as negative pricing, and that the right to make use of a MAC clause, hardship clause or appeal to the doctrine of frustration of purpose or other common law remedies has not been waived or otherwise disclaimed.

Steve: Thanks, Gabe. And really, what it means is if you want to know that you are going to be able to get a particular result, then you need to state it in the contract, and not rely on what the law might otherwise be. We know these are distressing times, we want to thank you for joining us during these times and to let you know, as I'm sure you do, that Akin Gump is ready to help you, so please feel free to reach out to your regular contact at Akin Gump, or of course any one of us. Thank you again and we will be in touch again soon.

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