Key considerations when acquiring or disposing of oil and gas assets

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Low oil prices have been causing negative headlines for some time. However, they present opportunities to cash-rich investors looking to acquire assets at discounted prices. Conversely, owners looking to monetise their interests will want to ensure they have their affairs in order in this buyers' market.

To ensure a favourable outcome, the following should be considered in the negotiation of:

Any acquisition/disposal of oil and gas assets
While each transaction must be reviewed on its own circumstances, common issues include:

- It is more important than ever to conduct a thorough due diligence exercise on the licence.
    - Many licence holders leave disposals far too late in the work programme cycle and risk losing their licences through non-performance before the transaction can be concluded.
    - The outstanding work obligations need to be carefully reviewed by the purchaser's commercial and technical advisers. Can the obligations be performed within the remaining term? Will third party factors (elections, strikes, weather, etc.) affect the timetable? How much influence will the purchaser have over the work programme (for example, the location of an exploration well/seismic activity)?
    - What provisions have been made for decommissioning and how can the parties protect themselves against bearing more than their fair share of liabilities?
- The parties should consider whether any provisions within the term sheet should be legally binding, for example, any representations or exclusivity provisions.
- Local counsel should be fully engaged from the outset to advise on the mechanics of the acquisition, how to go about obtaining any necessary government consents and other formalities required to obtain legal title to the interest. Timely instruction can avoid complications obtaining reliable, unconflicted counsel, particularly in small and/or challenging jurisdictions.
- The purchaser may wish to consider structuring the acquisition in a way that legitimately avoids the need to obtain governmental consent to the transaction.
- Tax advisers will need to advise on the tax implications of the acquisition. For example, if the acquirer is a foreign entity it will need to consider whether withholding tax is applicable.
- Both parties will need to give warranties on matters such as good legal title to the licence, subsistence of the production sharing contract (PSC) and its financial and technical capabilities. These will be subject to heavy negotiation between the parties.

- The purchaser (if a listed company) will need to consider if it can book reserves.
- Usual due diligence on the seller (what is its financial status and what is the insolvency risk? Can the seller stand by its contractual obligations or should they be backed by additional security?); its title to the assets; its power to enter into the transaction; the position of the assets vis-à-vis the sellers' other contractual arrangements, etc.

Farm-in and farm-out agreements

Farm-in agreements (and the raft of related documentation) take time to draft and negotiate. There is no widely used model agreement, so each tends to be drafted on a bespoke basis depending on the negotiated position.

If there is a joint operating agreement (JOA) in subsistence:

- The farminee should review the terms prior to adhering to such agreement and to ensure that the proposed farm-in is in compliance with its terms, for example, if the JOA contains pre-emption rights.
- The farminee should also consider what rights it requires under the JOA pending completion of the acquisition.
- Further, if the farminee party is to become operator, at least while it is under an obligation to perform the work programme, consents may be necessary to effect this change in operatorship. A review of the JOA/PSC/local laws will be necessary if this is to occur.
- If no JOA has been drafted, the parties will need to commence negotiations or consider appending an agreed heads of terms to the farm-in agreement pending completion. The JOA can then be drafted at a more leisurely pace based on the heads of agreement post acquisition.

A key point to be dealt with in the farm-in agreement is the allocation of liabilities arising before the effective date of transfer of the interest. Experience has shown this to be an area of attempted rejuvenation of negotiations post completion, so tight drafting is key to successfully ring-fencing liabilities.

If the farminee is a special purpose vehicle (SPV), the farminor may require parent company guarantees or other security for the obligations to be performed.

Finally, specific considerations will need to be borne in mind when documenting an 'exploration farm-in' (for example, which party is responsible for carrying out or subcontracting the seismic/drilling work?), an 'appraisal farm-in' (the farminee will become a party to the JOA and will want to exert influence over the development through the decision making process established in the JOA), and a 'development farm-in' (the commercial dynamics will need to be carefully documented in this type of farm-in because it is essentially a sharing of risk and reward).

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Earn-in clauses

Since the purchaser to an earn-in agreement will only receive title to the interest once it has performed specified commitments, such clauses need to be carefully negotiated and drafted.

Share acquisitions

If the target is a private company then a relatively straightforward acquisition can take place if the shareholders are willing to sell, although in practice the mechanics of the transaction, as opposed to the legal issues, will be more complex the more widely spread the shareholding in the company is. Additional regulatory hurdles must be overcome when dealing with public takeovers.

If the buyer decides to make a share acquisition, the nature of the purchase will also depend on the form of the target company and how it has been structured. Ideally for the buyer the target company will be a SPV that holds just the asset or assets that the buyer is interested in. If, however, the target holds other assets which the buyer may not have an interest in, the buyer may request that these be removed from the corporate structure prior to completion. The seller may push back if it is looking for a clean break in respect of such assets, or if tax liabilities will be incurred by transferring assets out of the company. Ultimately, the final position will depend on the relative bargaining powers of the parties.

As with all share acquisitions, the purchaser will wish to conduct a thorough due diligence exercise on the company (for example, on its employees, pensions, real estate, litigation and its contractual arrangements).

Swaps and strategic partnerships

Companies looking to divest may also consider alternative arrangements, such as swaps, which can also be a useful way of avoiding the standard pre-emption clause, and strategic partnerships.

Summary

This article does not attempt to provide a comprehensive list of considerations for investors/purchasers, merely an overview of the key risks we have seen in recent transactions. While the current market offers some excellent opportunities, would-be bargain hunters would be wise to remember 'caveat emptor'. Conversely, a seller who bears in mind these risks, and can demonstrate compliance with them, will be better placed to sell their asset, at an attractive price. ■