

DUE DILIGENCE IN A MIDSTREAM ACQUISITION

“KNOWLEDGE IS POWER”

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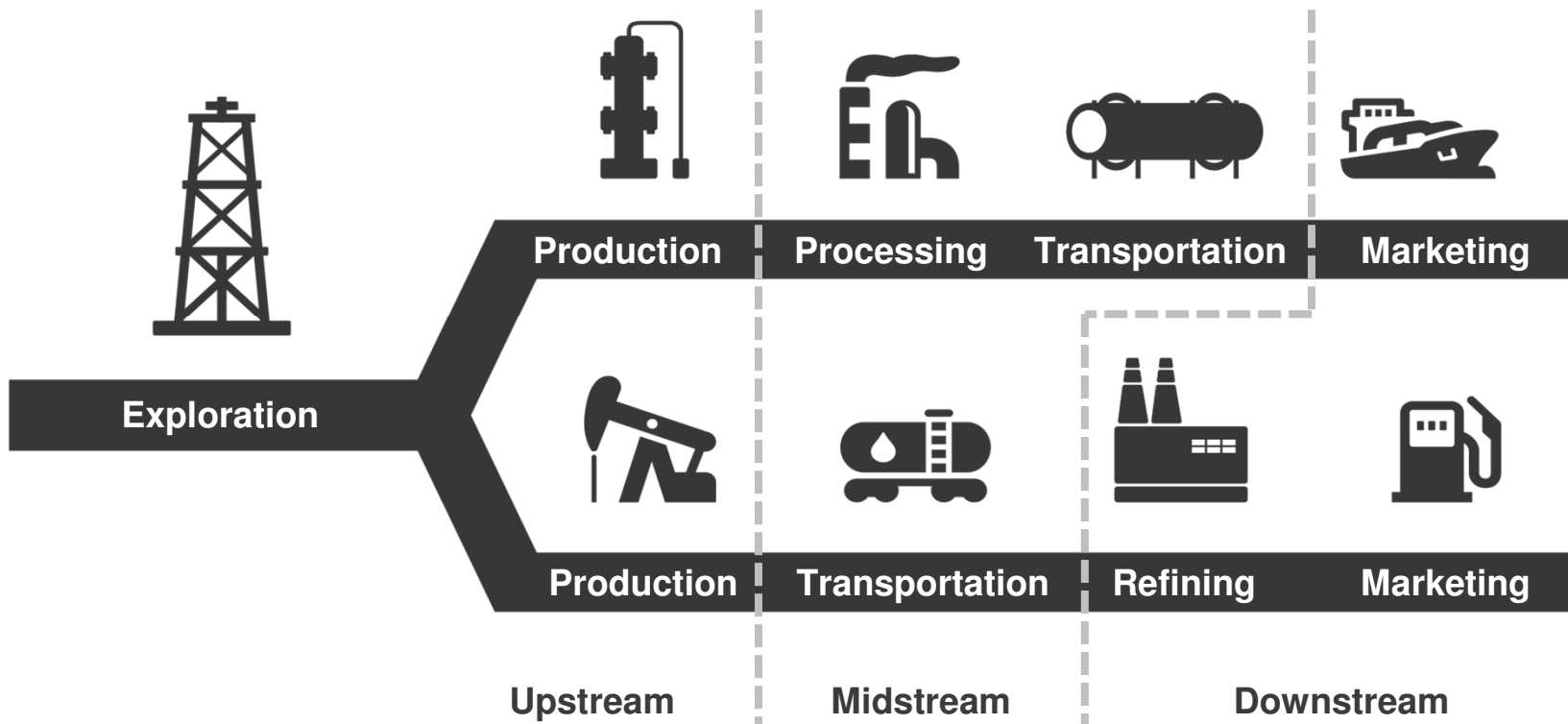
Primary Goals of the Presentation

- Insight into the purposes for, and value of, conducting diligence in a Midstream Acquisition.
- High-level overview of the principal steps involved in conducting a legal due diligence review in a Midstream Acquisition transaction.
- Awareness of certain areas which may warrant special focus in a Midstream Acquisition diligence effort.
- Appreciation of the interplay between the due diligence process and the definitive acquisition agreement.

I. Why is Diligence Required in a Midstream Acquisition?

Why is Diligence Required in a Midstream Acquisition?

- The oil and gas industry is comprised of three major segments: Upstream, Midstream and Downstream.



Why is Diligence Required in a Midstream Acquisition? (cont'd.)

- The Upstream segment is commonly characterized by oil & gas exploration and production (E&P) activities.
- The Downstream segment consists generally of the refining and processing of hydrocarbons into consumer products; however, the Midstream segment and Downstream segments can overlap and the term “Midstream” is often inconsistently used.
- The Midstream segment consists of the diverse transportation, storage and marketing assets and services that link the energy supply side (Upstream segment) with the demand side for energy commodities including delivery of hydrocarbons to the Downstream segment for conversion into consumable products.

Why is Diligence Required in a Midstream Acquisition? (cont'd.)

- A Midstream Acquisition target may own and operate varying types of facilities, conduct a broad array of activities and provide a broad range of services:
 - Crude and Natural Gas Gathering
 - Crude and Natural Gas Transportation Pipelines
 - Rail and Marine Transportation
 - Processing, Treating and Fractionation
 - Hydrocarbon and Hydrocarbon Product Storage
 - Product Terminalling and Transloading

Increasing Need for Midstream Infrastructure

- The midstream industry in the United States has seen significant changes over the past twenty years, and is currently experiencing rapid growth and consolidation opportunities.
- In 2013, the United States was recognized as the world's largest producer of hydrocarbons, in large part due to the increased drilling activities in various shale plays (including the Marcellus, Haynesville, Barnett, Eagle Ford and Bakken shales) and productive hydrocarbon basins (such as the Permian Basin).
- Natural gas gathering networks, gas processing facilities, fractionation plants, transportation pipelines for natural gas and natural gas liquids and other midstream infrastructure have been, and continue to be, in high demand due to the development of these shale plays.

Increasing Need for Midstream Infrastructure (cont'd.) ^{V&E}

- Many public and private companies have a focus on midstream activities, as well as venture capital firms and strategic investors which specialize in or have a strong focus on the development of midstream infrastructure:

Enterprise Products Partners
Kinder Morgan
Plains All American

Spectra Energy
Williams Companies
Energy Transfer Partners

ONEOK Partners
Enbridge Energy Partners
Targa Resources Partners

- In 2012, midstream M&A transactions in excess of \$44 billion in value were conducted in the United States and in the first half of 2013, over \$16 billion of midstream M&A transactions have been announced.
- In each of these domestic transactions, there were varying levels of due diligence completed in connection with the acquisition and disposition of the various midstream companies, divisions and assets.

II. Due Diligence Process

A. What is Due Diligence?

- Due diligence in the context of a Midstream Acquisition is simply stated: *the process by which a potential acquirer of a midstream business or division or group of midstream assets gathers and reviews information about the Midstream Acquisition target to reach an informed decision or confirm its decision to acquire the target business.*
- There are various kinds of due diligence conducted in a Midstream Acquisition, including:
 - Financial Due Diligence
 - Operating Due Diligence
 - Strategic Due Diligence
 - Legal Due Diligence
- Although Financial, Operating, Strategic and Legal Due Diligence often overlap and require interaction among the various specialists, our focus is on the requirements of Legal Due Diligence.
- In Legal Due Diligence, the acquirer, along with its in-house and outside legal counsel and other advisors, analyze the target business to determine (i) compliance with laws and regulations, (ii) legal title to assets, (iii) required consents to consummate the transaction and (iv) compliance with other legal requirements (including contract terms).

B. Why is it Important for the Acquirer to do Legal Due Diligence?

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The objectives of a legal due diligence investigation are much broader than simply trying to find the hidden problem or undisclosed liability.



B. Why is it Important for the Acquirer to do Legal Due Diligence? (cont'd.)

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The legal due diligence process serves many diverse purposes, some of which are intuitive and some of which are not as evident, including the following:

- Information Gathering and Validation of Value
- Confirmation of Business Assumptions
- Identification of Obstacles to Closing and Transition Issues
- Identification of Liabilities and Obligations
- Identification of Title and Operating Deficiencies
- Identification of Contract Provisions and Situations Which Could Impact Ownership of the Assets or Conduct of the Business

B. Why is it Important for the Acquirer to do Legal Due Diligence? (cont'd.)

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The above-stated objectives of a due diligence investigation make it apparent that due diligence is an essential and invaluable tool for the acquirer in a Midstream Acquisition which, when used properly, can help to:

- Minimize the risk of the acquisition
- Allocate identified and often unidentifiable risks between the transaction parties
- Maximize value to the acquirer's equityholders



C. Caveat Emptor – Prevailing Concept in a Midstream Acquisition

- Caveat emptor – “Let the Buyer Beware” – is a warning that a potential acquirer should heed.
- The seller of the target business has as his goal maximizing value to the seller and, the seller is not likely to volunteer disclosures which could result in a purchase price reduction or in the seller having to retain liabilities following the closing.
- The acquirer, in order to have a full and complete picture of the risks and liabilities being assumed in a Midstream Acquisition, must protect itself and should use all tools available to it to flush out issues and identify liabilities – including due diligence and a comprehensive definitive acquisition agreement.

D. Interrelationship Between the Due Diligence Process and the Definitive Acquisition Agreement

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- The more knowledge that a potential acquirer gathers about a target business, the better positioned the acquirer will be to structure responsive, effective and tailored representations and warranties in the definitive acquisition agreement and minimize risk and protect its investment.
- The results of a proper due diligence investigation prior to signing of the definitive purchase agreement may result in the acquirer changing the structure of the acquisition to address concerns which are discovered in the diligence process.
- Due diligence after the signing of an acquisition agreement may lead to the discovery of breaches of representations or warranties which are so material as to justify terminating the acquisition agreement or renegotiating the terms of the transaction.



E. How to Conduct Diligence – The Process

- There is no single matrix, model or guide to apply when a potential acquirer prepares and conducts legal due diligence in a Midstream Acquisition.
- Each diligence effort needs to be customized and tailored to the target company's business.
- The scope of the diligence effort and the timing and process for conducting the diligence will depend upon the nature of the target (i.e., private or public) and other variables.
- Early Preparation and Planning is the key to a successful due diligence effort.



F. How to Conduct Diligence – The Process (cont'd.) ^{V&E}

The Diligence Process can be broken down into various phases or steps:

Step One: Gain an Understanding of the Acquirer's Acquisition Plan and the Target Business

Step Two: Determine the Desired Scope and Goals of the Diligence Effort

Step Three: Enter into Confidentiality Agreements to Facilitate an Open Flow of Information

Step Four: Assemble a Diligence Team

Step Five: Prepare and Distribute a Due Diligence Request List

Step Six: Establish Contact Persons and Procedures for Gathering and Reviewing Information

Step Seven: Document and Communicate Diligence Findings

Step One: Gain an Understanding of the Acquirer's V&E Acquisition Plan and the Target Business

- Gain a good and detailed understanding of the acquirer's purchase and integration plan and of the target company's business.
- By understanding the acquirer's purchase assumptions and integration plan, the diligence team can better structure the diligence inquiries so to validate the acquirer's assumptions and uncover any obstacles to an orderly transition or integration.
- By understanding the target company's business, the diligence team can be more efficient in the diligence effort by eliminating areas which are not applicable and focusing on areas where particular scrutiny may be needed.

Step Two: Determine the Desired Scope and Goals of V&E the Diligence Effort

- The desired scope of the due diligence effort should be taken into consideration early in the process, including:
 - determining specific identified or anticipated risks (i.e., known environmental or regulatory problems) to be diligenced and scrutinized;
 - establishing materiality thresholds for contracts, and perhaps litigation proceedings, to be reviewed; and
 - deciding on the form, content and timing of reporting findings

Step Three: Enter into Confidentiality Agreements to Facilitate an Open Flow of Information

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- The initial goal of a due diligence process is to gather as much information about the target business as possible.
- In order to encourage the seller to be forthcoming with information (including proprietary and confidential information), it is typical for the acquirer and seller to enter into a Confidentiality Agreement. This agreement will:
 - Contain restrictions upon the potential acquirer's use and subsequent disclosure of the target company's disclosed information;
 - Contain provisions which address the ongoing obligations of the parties if the transaction is not consummated, including the destruction or retention of confidential information by the potential acquirer; and
 - Often establish the procedures for the seller to provide disclosures to the potential acquirer.
- Many sellers will request or require that other protective provisions also be included in the confidentiality or nondisclosure agreement:
 - a non-solicitation provision
 - a standstill provision
- In some instances where the seller and acquirer are significant competitors, the parties may need to be sensitive to antitrust law concerns and exercise stricter caution when delivering and receiving commercially sensitive or pricing information.

Step Four: Assemble a Diligence Team

- Once the scope of the diligence exercise has been determined, and the confidentiality agreement entered into, it is important for the acquirer to assemble a due diligence team and make sure that all members of the team understand the scope of the due diligence exercise and their respective responsibilities.
- A successful due diligence program (which is one which gathers the targeted information in an efficient manner and communicates the gathered information and data in a timely and useful manner to the acquirer) is a Collaborative Effort which requires a careful coordination between the acquirer's in-house team members and the outside professionals and advisors (including financial, investment banking and legal advisors).
- A clear allocation of duties and responsibilities can streamline the diligence process.
- Once the acquirer's diligence team is formed, it is often a good idea to have a kickoff meeting with principals of the seller to communicate the goals of the diligence effort and the anticipated process and procedures.

Step Five: Prepare and Distribute a Due Diligence Request List

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- It is typical for the acquirer to prepare a due diligence request list for delivery to the seller which specifies documents and information the acquirer wishes to receive and review.
- The due diligence request list should be comprehensive but not so overly broad or burdensome as to overwhelm the seller and its management team.
- Specialists in relevant areas (i.e., tax, environmental, employee benefits, etc.) should be consulted and have an integral role in creating the due diligence request list.
- The due diligence request list will serve as the guide for identifying and cataloging the information received from the seller.
- Remember that the diligence process is a constantly evolving process and as better knowledge surrounding the target is obtained, supplemental diligence requests may be necessary.

Step Six: Establish Contact Persons and Procedures ^{V&E} for Gathering and Reviewing Information

- The due diligence process is an Interactive Process between the seller, the acquirer and their respective representatives.
- Experience has proven that designating a contact person at each party who is responsible for fielding and responding to diligence requests will facilitate a more efficient and effective process and result in less anxiety and better efficiency.
- It is often helpful early in the due diligence process to determine how the disclosing party will disseminate or make available materials to the acquirer in response to the diligence request. There are several ways this can be done:
 - assembly of hard copies at the seller's offices;
 - delivery of hard copies to the acquirer;
 - delivery of documentation electronically via a disc of all response documents; or
 - the establishment by seller of an electronic, virtual, and interactive data room where the response documents will be deposited and designated members of the acquirer's diligence team will be provided password protected access.
- Organization is crucial in processing information – it is imperative that the entire team approach the due diligence process in an orderly and logical fashion.

Step Seven: Document and Communicate Diligence Findings V&E

- At the front end of the diligence process, the acquirer and its representatives should establish the preferred method for acquirer to receive the results of the diligence process:
 - periodic conferences or conference calls (i.e., daily, weekly, etc.)
 - summary of written results
 - preparation of a formal and detailed memorandum
- Gathering and memorializing diligence information has little value unless the information is timely communicated to the decision makers for use in negotiations.
- If communicated in a timely and useful manner, due diligence information can (i) drive changes to the business/economic terms and (ii) influence risk allocation between the parties.

III. Areas of Particular Concern for a Due Diligence Team in a Midstream Acquisition

Areas of Particular Concern for a Due Diligence Team in a Midstream Acquisition

In almost all M&A transactions (whether or not in the energy sector or the midstream segment) there will be a number of fundamental areas for diligence including the following:

- general corporate matters (i.e., governing documents, qualifications to do business, capitalization, and organizational structure);
- compliance with laws;
- pending and threatened litigation, proceedings, consent decrees and investigations;
- financial and accounting matters;
- personnel/employee benefits/labor matters;
- environmental matters;
- governmental regulation (i.e., permits, licenses, approvals and consents);
- intellectual property (i.e., patents, licenses, trademarks and tradenames);
- tax exposures and compliance;
- indebtedness;
- compliance with material contracts;
- ownership and condition of real property interests; and
- ownership and condition of personal property.

Areas of Particular Concern for a Due Diligence Team in a Midstream Acquisition (cont'd.)

- Due to the unique nature of midstream assets and operations, traditional due diligence approaches which have been applied in other energy transactions may not be practical and it is important that the persons designing the scope of the diligence review for the midstream target have a good comprehension of the midstream industry and the critical elements and risks arising therefrom to achieve a successful due diligence effort.
- Certain of the areas where particular diligence focus may be warranted are:
 - Identification of the Purchased Assets
 - Real Estate Matters including Rights of Way
 - Environmental Matters
 - Regulatory Matters (i.e., FERC jurisdiction)
 - Contract Provisions

A. Identification of the Purchased Assets

- A critical aspect of midstream due diligence (which can be overlooked) is obtaining and verifying a full and accurate description of the current and past assets of the target company including not only a physical listing of the assets but also a historical profile reflecting (i) current and past ownership (ii) age (iii) operational history, and (iv) operational specifications.
- Apply an inquisitive “who, when and where” approach to understanding the assets and you will gain a better assessment of potential risks associated with future ownership and operation of the assets.
- The acquirer will also want to know pending and threatened complaints, investigations or proceedings affecting the assets.
- Often by reviewing the detailed asset list, the diligence team may also discover that the seller has included a few “stray cats and dogs” which are not useful to or required by the acquirer for its ongoing operations and which could possibly subject the acquirer to exposure, or require it to incur additional costs in the future.
- If the due diligence effort discovers potentially risky but unneeded assets prior to execution of the definitive purchase agreement, then the acquirer will have the opportunity to either (i) reject the assets and require that they be excluded from the transaction and become the responsibility of the seller or (ii) accept the troublesome assets but quantify the risks associated with them and exact a corresponding reduction in the purchase price.

B. Real Estate Diligence

- In Midstream Acquisitions (which often can involve hundreds or thousands of miles of pipeline facilities, compressor pads, storage caverns and storage wells), the real estate diligence effort can be very extensive and time consuming.
- The expense and time required to complete real estate diligence in a Midstream Acquisition can be heavily influenced by the quality of the seller's real estate records and right of way files.
 - There are several types of real estate interests which an acquirer is likely to encounter in a typical Midstream Acquisition including:
 - Fee Simple Ownership of Tracts
 - Leasehold Estate
 - Easement or Right-of-Way
 - License
 - Permit

B. Real Estate Diligence (cont'd.)

Real estate-related diligence in a Midstream Acquisition due diligence effort should include a verification that:

- Ownership: The applicable entity actually has good and valid title to the real property interests necessary to operate the target business;
- No Liens: There are no liens against the real property interests which could interfere with acquirer's ownership or use of such assets or detract from the value of such assets;
- No Use Restrictions: There are no restrictions or other encumbrances that can interfere with the current and intended use of the real property interests;
- No Adverse Rights Triggered: There are no restrictions on transferability, change of control provisions, purchase options or preferential purchase rights which will be triggered as a result of the consummation of the subject transaction; and
- Ancillary Rights: Each site has the necessary off-site easements and other rights necessary to operate the site (such as utilities, railroad spurs and pipelines for raw materials supply and finished product off-take).

B. Real Estate Diligence (cont'd.)

- Diligence teams conducting real estate diligence in the midstream sector often apply the 80/20 Rule as the standard which guides their diligence efforts.

Such rule, loosely interpreted, provides:

- Don't spend 80% of the diligence time dealing with assets comprising 20% of the value. More specifically, where the real estate review of all assets will be a formidable task, the diligence team might need to focus on the real estate assets which attribute the greatest value to the target company.
- Obtain from the seller the relative valuation of assets/segments based on their contribution to EBITDA or cash flow, not necessarily their cost or replacement cost. Focus on and check a higher percentage of the higher value properties/segments and a lower percentage of the lower value properties/segments.
- Particularly for pipeline and gathering lines, the diligence team may elect to spot check the files as opposed to reviewing every file. It may not be practical as a matter of time or expense to review every minor easement.

C. Environmental Diligence

- Midstream Acquisitions, due to the diverse nature of the facilities that comprise midstream assets, require an extensive analysis of the target business' compliance with applicable environmental standards which impose various requirements relating to spills and releases, waste transport and disposal activities, wastewater and stormwater discharges and air emissions.
- The clear trend in environmental regulation of midstream activities is to place more restrictions and limitations on activities that may affect the environment, requiring owners and operators to incur potentially significant operating costs and capital expenditures to attain and maintain compliance.
- Proper Diligence is crucial – failure to comply with environmental requirements can result in (i) the assessment of administration, civil and criminal penalties, (ii) the imposition of investigatory, monitoring and remedial obligations, and (iii) possibly the issuance of injunctions which may limit or prohibit some or all of the activities of the target business.

C. Environmental Diligence (cont'd.)

The primary environmental regulatory issues relating to soil, water, waste and air compliance issues for typical midstream assets includes compliance with the following statutes:

- Clean Air Act (including air emissions permitting, NSPS and NESHAP program compliance, and greenhouse gas monitoring and reporting activities)
- Clean Water Act (including wastewater and stormwater permitting and discharges thereunder as well as jurisdictional wetlands in the event of pipeline expansion)
- Resource Conservation and Recovery Act (including management, transport and disposal of wastes)
- Comprehensive Environmental Response, Compensation and Liability Act (including management, disposal and any releases of hazardous substances)
- Endangered Species Act (including surveys and mitigation strategies to the extent that any expansion of pipelines or facilities is being considered)
- State Department of Environmental Quality Requirements (including past spill incidents and other releases that may have impacted soils, groundwater and/or surface water, resulting in possible obligations to investigate and remediate)

C. Environmental Diligence (cont'd.)

The key environmental laws governing pollution liability associated with a midstream business are:

- Comprehensive Environmental Response, Compensation and Liability Act
- All Appropriate Inquiry (AAI) rule (the current standard for satisfying the AAI rule is performance of an ASTM E1527-05 Phase I environmental site assessment (ESA) but the EPA has proposed rulemaking to use a new standard, ASTM E1527-13, in addition to the current 2005 standard).
- In addition to the foregoing, some states (such as Texas) have an additional oil and gas regulatory commission or agency that can be responsible for monitoring and regulating various components of midstream operations.

C. Environmental Diligence (cont'd.)

- It is common for the potential acquirer to negotiate the right to access and perform site visits at the real properties and cause a Phase I ESA assessment with respect to the facilities and activities of the target business to be conducted by an environmental consulting firm.
- The Phase I assessment is a limited investigation (which normally includes a site visit and records review but doesn't include any invasive sampling at the various sites).
- It is possible that the Phase I assessment will reveal areas of concern which warrant additional testing (including invasive investigation and sampling – Phase II testing) for the acquirer to be able to properly assess the magnitude of the risk.
- As a result of findings through environmental diligence, there may be (i) a purchase price reduction (in acknowledgment of the costs that the potential acquirer will incur to address a deficiency), (ii) an agreement that the seller will cure the deficiency (either pre- or post-closing) at its own cost or (iii) perhaps, removal of the asset with the deficiencies from the asset package.

D. Regulatory Diligence

- Most midstream operations and activities are not regulated by the Federal Energy Regulatory Commission (“FERC”), including with respect to rates and tariffs, and the primary regulatory body is an agency of the state in which the midstream assets are located.
- To the extent, however, that an intrastate pipeline system delivers hydrocarbons into interstate commerce, FERC may have jurisdiction over the pipeline, although it could be limited jurisdiction.
- As a result, regulatory counsel for the acquirer should, as part of the diligence effort, review the jurisdictional status of the midstream assets to determine the likelihood that FERC would determine the facilities to be jurisdictional and thereby subject the operations to federal regulation.
- Failure to comply with federal and state regulations (including regulations relating to transportation of hydrocarbons and construction, abandonment and interconnection of physical facilities) can result in the imposition of administrative, civil and criminal penalties.

E. Contracts Diligence

- Acquirers may be concerned about certain contractual obligations, such as (i) “take or pay” provisions (ii) change of control triggers (iii) non-competes (iv) assignment restrictions (v) obligations to construct infrastructure for the benefit of producers or other third parties, or (vi) exclusivity arrangements.
- Also, in the current midstream environment, master limited partnerships (“MLPs”) constitute a significant portion of the midstream companies active in the United States and due to their unique “pass through” tax structure. Where the acquirer is a MLP (or an entity which has plans to become a MLP through an initial public offering), it is likely that an additional component of the due diligence effort will be for the diligence team to review the operations and material commercial contracts of the target company to confirm that the income generated by the target company is “qualifying income” for tax purposes.

IV. The Use of Representations, Warranties and Indemnities to Reduce or Minimize Risk

The Use of Representations, Warranties and Indemnities to Reduce or Minimize Risk

- Another valuable mechanism or tool available to an acquirer to allocate deal risk, which is closely connected to the due diligence process, is the inclusion of representations, warranties and indemnities in the definitive acquisition agreement.
- The extent and scope of representations and warranties in the acquisition agreement are generally the most heavily negotiated areas in the selling or buying of a midstream business.
- Extensive Representations and Warranties are not always a substitute for a careful diligence effort:
 - Ability to be in a position to not proceed
 - Avoid indirect post closing costs of addressing the problem
 - Limitation on Recoverable Damages
 - Loss of strategic assets
 - Litigation required for recovery

A. Purpose for Representations, Warranties and Indemnities

The sellers' representations and warranties can serve many of the same purposes and provide comparable benefits to the acquirer as the due diligence process, including:

- Information Gathering: Eliciting information about the target company and its business and assets;
- Required Approvals, Consents and Filings: Providing information respecting required approvals, consents and filings;
- Risk Identification: Identifying known risks and providing the basis for allocation of such known risks as well as unknown risks; and
- Allocation of Risks and Responsibility: Providing the framework for the acquirer's remedies for a breach of the representation or warranty (i.e., discovery of a liability which was not disclosed) which remedy can be termination of the acquisition agreement if the breach is discovered prior to closing or indemnification from the seller if the breach is discovered post-closing.

B. Factors Affecting the Breadth of Representations and Warranties

The breadth of the representations and warranties which a potential acquirer may exact from a seller often depends upon the circumstances surrounding the transaction:

- If the acquirer is paying a premium value for the target business and there are few or no competitors in the sale process, then the acquirer would have a better opportunity and leverage to insist upon broad and comprehensive representations and warranties with few qualifiers and which allocate as much risk as possible to the seller.
- If the acquirer is competing in a competitive bid process for the target business, the acquirer may be more willing to accept and the seller may have more leverage to insist upon narrower and less comprehensive representations and warranties and thus greater risk upon the acquirer.

C. Negotiated Limitations on Representations and Warranties

It is likely that the seller will seek to limit its representations and warranties (and therefore shift transaction risk to acquirer) in the following ways:

- Materiality: The seller may attempt to qualify representations and warranties by what is material (which may be a specified monetary amount) or by what might cause a material adverse effect on the target business.
- Knowledge: The seller may seek to qualify certain or all of its representations and warranties by the actual knowledge of an identified group of officers of seller.
- Scope: The seller may request that certain representations and warranties be limited to certain designated disclosure materials (i.e., types of contracts).
- Timing: The seller may attempt to limit specific representations and warranties to apply only as of a specified date or particular time period.

D. Negotiated Limitations on Indemnification

It is also common in Midstream Acquisitions for the seller to seek to limit the scope of its indemnification obligations in the following ways:

- Limited Survival. The seller may request short survival periods during which an indemnification claim can be made for a breach of representations and warranties or no survival.
- Limitation on the Types of Recoverable Losses. The seller may seek to limit the types of damages which can be recovered under the indemnification provisions and particularly “consequential, indirect and punitive” damages.
- Thresholds and Deductibles. The seller may seek to have its indemnification obligation be subject to threshold baskets or deductibles that are designed to provide the seller assurance that, even in the event of a breach of a representation or warranty, the seller will only have responsibility for material claims. Under a threshold basket, the seller is liable for the total amount of all losses, including the amount required to fill the basket. Under the deductible, the seller is liable only for the excess amount of losses above the deductible.
- Liability Caps/Ceilings. The seller may seek an absolute cap on the amount of indemnifiable losses payable to acquirer in the event of a breach of a representation or warranty. It is not uncommon in Midstream Acquisitions to have liability caps of 10 to 25% of the total purchase price. Certain fundamental representations and warranties (which often include title) may be carved out as an exception to the liability cap.

D. Negotiated Limitations on Indemnification (cont'd.)

- No matter how thorough the due diligence effort is, certain unknown liabilities may escape the due diligence review. Additionally, it is possible that the seller (either intentionally or inadvertently) may fail to disclose various liabilities or matters, which can have adverse consequences to the acquirer following closing.
- Accordingly, the representations and warranties of the seller to be included in the acquisition agreement should be carefully crafted and the indemnification from the seller must be carefully negotiated so that the acquirer will have recourse against the seller if certain risks or liabilities arise prior to or after the closing.
- Also, don't lose sight of the fact that an indemnification covenant is only as good as the ability and wherewithal of the seller to pay. Accordingly, it may be necessary for the acquirer to request (i) a parent guarantee (ii) a purchase price hold back, or (iii) an escrow to provide a viable source of recovery in the event of a breach and resulting indemnification claim.

E. Specific Representations and Warranties

There are certain particular representations and warranties which an acquirer in a Midstream Acquisition may try to obtain from a seller as follows:

- Inventories
- Imbalances
- Capital Commitments and Producer Obligations
- Regulatory Matters
- Condition of the Assets
- Sufficiency of the Assets
- Rights of Way/Easements

F. Broad Representations which Shift Risk

- In addition to representations and warranties which address specific midstream matters, the acquirer may seek to include broad representations and warranties in the definitive acquisition agreement to shift the risk of certain unknown liabilities to the seller. This is particularly the case where the acquirer has not had the opportunity to complete a thorough due diligence investigation prior to execution of the acquisition agreement.
- These broad representations are generally heavily negotiated and include:
 - No Undisclosed Liabilities Representation. This representation is designed to protect the acquirer against any unknown liabilities which have not otherwise been addressed in specific representations.
 - Full Disclosure (10b-5) Representation. This representation basically requires the seller to represent that seller has not made any untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Although 10b-5 representations are common in issuances of public securities, they are the exception, rather than the rule in Midstream Acquisitions.
- Another way that the due diligence process complements the acquisition agreement negotiations is that specific liabilities or risks which were discovered in the due diligence process may become designated as “retained liabilities” under the definitive acquisition agreement.

V. Conclusion

Conclusion

- Tools to Minimize Deal Risk. A comprehensive due diligence review and the inclusion of focused representations, warranties and indemnities in the definitive acquisition agreement are two tools which are invaluable to a potential acquirer in a Midstream Acquisition and can minimize deal risk.
- Knowledge Means Power. In negotiating a Midstream Acquisition, knowledge in the hands of the acquirer means power, and due diligence and representations and warranties are the two primary means of gaining better insight into and knowledge of the target company's business.
- Benefits to the Acquirer. The knowledge gained from an effective due diligence process and properly crafted representations, warranties and indemnities will allow the acquirer to properly assess and allocate the transaction and business risks associated with the Midstream Acquisition and increase the likelihood that (i) the acquirer, upon closing, preserves the value of its investment, (ii) receives the full benefit of its bargain, and (iii) has an efficient transition or integration of the acquired business.

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