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'Seller Capitulation' Fueling Increase in Sale of Energy Sector Assets

Editor's Note: This is one in a continuing series of Q&As with Locke Lord lawyers on key legal issues confronting companies engaged in industries that have national and global impact.

What are the key issues confronting the energy sector today that investors – particularly private equity investors – need to be aware of as they look for energy investment opportunities?

A: We see increasing signs of "seller capitulation" – e.g., increased bankruptcy filings, increased concerns about liquidity and access to capital, increased pricing pressure – that are motivating potential sellers to sell assets or businesses in order to pay down debt and increase liquidity. That's the good news for potential buyers of companies. The challenge for buyers, as always in these situations, is deciphering whether they are buying a "falling knife," or instead are buying quality companies or assets at attractive prices, with the opportunity to generate a significant upside. Adding to that challenge is the fact that downturns tend to result in more litigation risk, more employment-related claims and more counterparty credit-risk. Careful due diligence by buyers can help mitigate that risk, as can strong indemnities and – increasingly – rep and warranty insurance products.

How can private equity companies get more value out of their assets now and also when they sell these assets when oil prices rebound?

A: For private equity companies that already own energy assets, the key to success is controlling costs during the down cycle so that their companies survive to take advantage of the inevitable rebound. Keeping liquidity as high as possible while keeping debt as low as possible will help position those companies to take advantage of opportunistic buying opportunities. We have already seen many of our private equity clients benefit from limited, strategic buying opportunities – and expect that many more will do so in the second half of the year. But those opportunities are only available to those that have the balance sheet flexibility to take advantage of them. They will also need patience, as this downturn is shaping up to be a long one – longer still if the nuclear treaty with Iran is ratified and they begin contributing to the global industry oversupply.

Where are the best strategic investment opportunities currently in the energy sector? Upstream? Alternative? Midstream? Oilfield Services?

A: Certainly the midstream sector is where we have seen the most investment and M&A activity during the first half of 2015. Even in a "short term" low commodity price environment, the US continues to have a very strong longer term need for midstream infrastructure. Many of the most prolific shale plays are in regions that historically have not seen meaningful oil and gas activity – and so don't have the infrastructure they need to move fossil fuels to markets, or to process those fossil fuels.

We also have seen an uptick in upstream activity in the last couple of months, as more and more upstream companies find themselves needing – or at least wanting – to find buyers or investors to help them maneuver through the current downturn. We expect that some of the recent bankruptcy filings of upstream companies are both an indicator of and a catalyst for additional buying opportunities.

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