A perfect storm

By Rebecca Major

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In spite of the current economic, political and sanitary climate, we are seeing, and expect to continue to see, merger and acquisitions (M&A) deals in Africa's oil and gas industry.

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These include:

- deals already agreed before Covid-19/the drop in oil and gas prices;
- sellers looking to sell to raise money; and
- buyers with cash/available credit lines looking to leverage opportunities.

Buyers and sellers have been checking the sale and purchase agreements (SPAs) that they have already signed and have been very carefully considering the SPAs that they are about to sign. Here are some considerations that may be top of mind in the current circumstances.

Price adjustment

For many deals, the price for the asset/company is fixed on a past date (a locked box date or retroactive effective date). In this case, there is a risk of value fluctuations between that date and the date of the actual closing of the deal. This can be significant where oil and gas prices or production have significantly decreased since that date. The parties may still have to close at the original price in these circumstances. If on the other hand the price is calculated based on value at the closing date, then the parties may be better protected against any sudden increase or decrease in oil and gas prices or production levels. Deferred price mechanisms based on future performance might also be helpful. We think it is likely that we will see parties being more creative with pricing mechanisms in future deals, with both parties looking to mitigate their risks.

Termination provisions

SPAs often include provisions enabling one or other of the parties to terminate the SPA between signing and closing if certain circumstances arise. Generally, the objective of the seller is to achieve as much certainty as possible. Therefore, a seller will only accept very limited rights for the buyer to terminate the SPA before closing. On the other hand, the buyer will generally not want to be bound into a deal that is not as good as was expected when the SPA was signed.

- **Material adverse change:** this enables one or both of the parties to terminate the SPA before closing in the event that something significantly affects the value of the target asset/company. Discussions generally revolve around (i) what kind of event should be covered: political crises in country, significant damage to the asset, significant fluctuations in oil and gas prices; and (ii) whether there should be some kind of materiality threshold: for example, a decrease of 10 or 25% in the value of the asset. These kinds of provisions are generally fiercely negotiated and may not be accepted at all. They relate to the asset and not the financial position of the buyer (or the seller) and will generally not relate to the state of the oil and gas industry as a whole (for example a decrease in oil and gas prices – although this may be a point of negotiation).
- **Force majeure provisions:** we do not see this kind of provision in an M&A SPA systematically. This is on the basis that there are not a lot of events that can make it impossible for the seller to sell, or for the buyer to pay. There are no physical delivery requirements for example, in the way that we would see for an oil or LNG SPA or a construction contract. Under some laws (for example French law) force majeure/hardship might be implied into a contract even though they are not expressly stated. We have recently been confronted with situations where it has become harder to either fulfil conditions precedent or complete deals because the relevant government authorities are closed, because the company books are in the office and the local lawyer/company secretary cannot leave his/her home, or because the buyer cannot convert local currency into foreign currency. This may lead to parties being more inclined to include force majeure clauses in their SPAs and/or seek to imply them where they are not expressly included to justify delays or, ultimately, termination. However, it should be noted that these provisions can generally only be triggered where it is impossible to do a deal; not where it is just more difficult or economically less favourable for one of the parties.
- **Material breach of representations and warranties:** this may entitle a buyer to terminate an SPA before closing. Representation and warranties generally do not include any kind of comfort in relation to oil and gas prices, availability of reserves, production levels or political issues. However, current circumstances might give rise to breaches such as:
    - breach of a warranty that there is no event of default under of any of the financing arrangements: low oil prices and/or a suspension of production may trigger events of default relating to financial covenants;
    - breach of material project contracts (for non-performance, non-payment); and
    - the target is unable to pay debts as they fall due.
- **Ordinary course of business:** there is often a requirement for the seller to carry on its business in the ordinary course of business between signing and closing. There may be arguments that the business has not been carried on in the ordinary course of business because it is shut down, production has been significantly decreased etc.

Indemnities

- **Tax:** we predict that governments will be tougher in terms of taxing deals in the future and carrying out post-closing audits, as they seek to compensate for revenue losses. We are therefore looking even more closely at tax warranties and indemnities and encouraging our clients to manage this risk carefully.
- **ESG (environmental, social and governance issues):** prior to Covid-19 and the oil price collapse, this was the key point in the minds of most oil and gas companies and should not be forgotten. Sellers looking for a clean exit, or buyers looking to avoid having to take on past issues, should negotiate pre and post-closing indemnities carefully on this basis.

Due diligence

Some of the issues that are front of mind at the moment (in addition to the key problem of actually valuing an asset) include:

- **identity and financial stability of key partners:** joint venture partners, key contractors and subcontractors, lenders, governments;
- **flexibility under underlying contracts and ability of either party to renegotiate or terminate or suspend certain contracts:** financing arrangements, host government contracts, product sale and purchase arrangements,

supply arrangements, construction contracts, employment contracts; and
- **political risks:** increased nationalism, foreign investment and merger control restrictions, sanctions.

ABOUT THE AUTHOR

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