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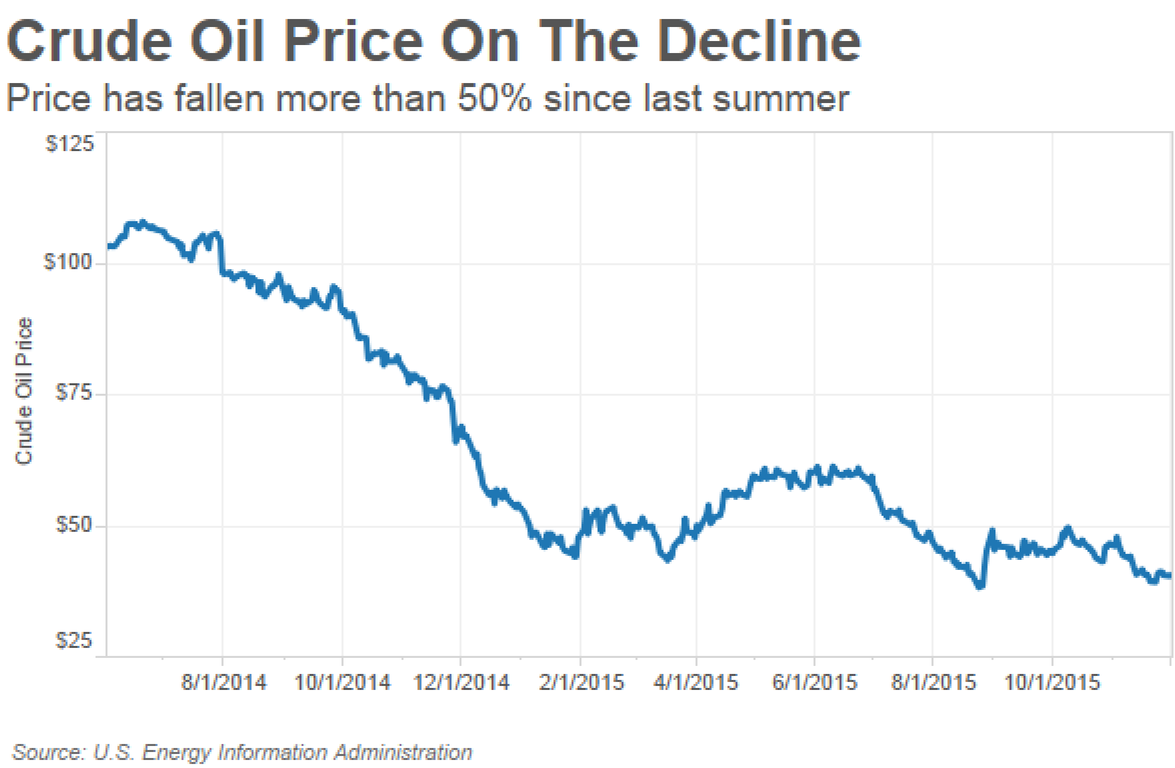
5 Energy M&A Trends Amid 2015 Oil Price Slump

By **Keith Goldberg**

Law360, New York (December 9, 2015, 12:02 PM ET) -- While 2015 saw a handful of energy megadeals, from Royal Dutch Shell PLC's proposed $70 billion cash-and-stock acquisition of BG Group PLC to Energy Transfer Equity LP's $37.7 billion merger with The Williams Cos. Inc., the slump in oil prices led to an overall deal-making malaise.

With oil prices struggling to stay above the $40-a-barrel mark after topping $100 a barrel in the summer of 2014, plenty of cash-strapped energy companies needed to make deals in order to stay afloat. Yet continued uncertainty over the future of oil prices has kept buyers and sellers apart in valuing assets poised to change hands.



"The current price: is that the right price, or should you be getting more because of future upside?" said

Cliff Vrielink, the co-head of Sidley Austin LLP's global energy practice. "That's what the industry has been thinking about this year."

Even companies who are in solid financial shape are hesitant to put assets on the market for fear their sales will be tainted by highly leveraged companies looking to get whatever they can for their assets in order to survive.

"They don't want to be sellers right now because there's going to be a lot of assets coming onto the market for companies that are overleveraged," Holland & Knight LLP partner Fred Stovall said. "For those companies, it's a fire sale."

Amid this environment, here are five mergers and acquisitions trends that stood out to energy attorneys in 2015:

Midstream Deal-Making Started Fast But Tailed Off

With most upstream oil and gas companies focused more on cutting exploration and production costs than cutting deals, the midstream sector carried the oil and gas M&A flag for most of 2015.

The Energy Transfer-Williams merger will create one of the world's largest midstream companies. Meanwhile, Marathon Petroleum Corp.'s master limited partnership MPLX LP agreed in July to buy MarkWest Energy Partners LP in a cash-and-unit deal that would create the fourth-largest MLP in the U.S., with a $21 billion market cap.

There were plenty of asset deals within the midstream sector as well, such as NextEra Energy Partners LP paying $2.1 billion for private pipeline developer NET Midstream LLC and its seven gas pipelines in Texas.

"Relatively to every other part of the energy value chain, midstream was where the action was," said Bill Swanstrom, the co-chair of Locke Lord LLP's energy practice group.

Yet deal activity slowed toward the end of the year as midstream companies started feeling the pain of low oil prices with their upstream suppliers slashing their production activity.

"The midstream is dealing with the distressed dynamic that the upstream sector is dealing with," Hogan Lovells partner Keith Trammell said. "Rather than a [deal-making] tsunami, it petered out."

That includes the MLP space, which most observers had pegged for significant consolidation. The Enterprise and MarkWest mergers aside, most of the significant tie-ups in the sector were asset swaps between MLPs controlled by the same company, or companies consolidating their own MLPs.

That included ETE's Energy Transfer Partners LP buying all the publicly held units of affiliate Regency Energy Partners LP in an $18 billion deal, and Crestwood Equity Partners LP and Crestwood Midstream Partners LP merging into a single MLP worth roughly $7.5 billion.

"I suspect that is because there has not yet been agreement between the potential consolidators on value," said Akin Gump Strauss Hauer & Feld LLP partner John Goodgame, who works in the MLP space. "The consolidation may have been pushed off somewhat because capital markets were open in the first half of the year."

Oil Field Services Led Upstream Consolidation Charge

With oil and gas producers slashing billions of dollars from their drilling budgets amid the oil price downturn, it's no surprise that the oil field service firms that do most of the work have been the first to seek safety in numbers, attorneys say.

"The services business is just getting killed, and they're the point of the spear," Stovall said. "Whenever there's a downturn in commodity prices, they're the first ones to feel the bite. They're frankly the easiest place for upstream companies to cut back."

In August, Schlumberger Ltd., the world's largest oil field services company, agreed to buy rival Cameron International Corp. for $12.7 billion. The deal recently got the thumbs-up from U.S. antitrust regulators.

Meanwhile, Halliburton Co. and Baker Hughes Inc., the world's second-largest and third-largest oil field service firms, respectively, have spent most of 2015 trying to persuade antitrust regulators to sign off on their $34.6 billion merger, pledging to divest billions of dollars worth of businesses in order to get the green light.

"One way you get rid of excess capacity is combining companies," said Tom Moore, the co-head of Mayer Brown LLP's global energy group. "That's going on and will continue to go on, but in the future, the good targets may be already snatched up. In the future, you'll see a lot of shotgun weddings where less strong companies are essentially put out of their misery."

Private Equity Firms Held Their Fire

The plunge in oil prices has put the financial squeeze on many oil and gas producers, creating a golden opportunity for cash-flush private equity firms to snap up distressed assets on the cheap. However, that didn't translate into many big acquisitions this year, attorneys say.

"You've seen big swaths of private equity looking to snap up many distressed assets, but not as much as people would have hoped," said Paul Dickerson, the former chief operating officer for the U.S. Department of Energy's Office of Energy Efficiency and Renewable Energy who is now of counsel at Mintz Levin Cohn Ferris Glovsky & Popeo PC. "Certainly one surprising trend has been the lack of deal flow for acquisitions in the distressed space."

Like everyone else in the oil and gas industry, private equity firms are waiting to see if the worst of the oil price slump is over before pouncing on deals, said David Buck, who co-chairs Andrews Kurth LLP's corporate/securities practice group.

"Right now, nobody knows whether the trend is another 12-month, or 24-month cycle," Buck said. "Until people have an indication of a catalyst for the commodity price improving, I see private equity firms being patient before entering into new investments."

One area that private equity is jumping into is joint drilling ventures with oil and gas producers. In January, funds managed by Blackstone Group LP's credit unit GSO Capital Partners LP agreed to sink $500 million into a drilling venture with Linn Energy LLC. Two months later, Linn secured a $1 billion investment from Quantum Energy Partners to create an entity focused on acquiring oil and gas assets for development, and EIG Global Energy Partners went a step further by sinking $1 billion into oil producer MLP Breitburn Energy Partners LP through a combination of equity and debt.

"They're a way for operators who have strong acreage positions but currently don't have the capital to drill these wells to bring in financing that's off their balance sheets," Akin Gump partner Michael Byrd said. "For investors, it's a way for them to get into the industry and earn an attractive, risk-adjusted rate of return."

Still, with financial markets remaining choppy and capital markets remaining tight, it may be up to private equity firms and other nontraditional investors to speed up the overall deal-making flow that has slowed amid the plunge in oil prices, attorneys say.

"The key issue is going to be the extent alternative capital providers are going provide recovery capital or M&A-type capital," said Keith Fullenweider, who co-heads Vinson & Elkins LLP's M&A and capital markets practice group. "It's going to be private, nonbank lenders that are key to whether deals get done next year."

Gas-Fired Power Dominated Utility Deals

With interest rates still low and regulated utilities still seen as relatively safe investments, multibillion-dollar deals within the power sector kept coming in 2015. Those deals carried a decided odor: natural gas.

In July, South Dakota-based utility Black Hills Corp. agreed to buy natural gas utility SourceGas Holdings LLC from investment funds managed by Alinda Capital Partners LLC and GE Energy Financial Services in a deal worth $1.89 billion. A month later, Southern Co. agreed to buy gas infrastructure utility AGL Resources for $8 billion. And in October, Duke Energy Corp. agreed to pay $4.9 billion for gas utility Piedmont Natural Gas Co. Inc., one of its partners in a $5 billion pipeline project along the Atlantic Coast.

Even on the unregulated side, merchant power companies including Calpine Corp., Talen Energy Corp. and the merchant power unit of private equity giant The Carlyle Group LP spent billions of dollars snapping up gas-fired plants.

"It seems like a logical fit, if [power generators] continue to rely on gas-fired plants for a significant portion of their [electric] load," Winston & Strawn LLP partner Jonathan Birenbaum said. "If you look at the profile of the plants for utilities, gas-fired plants are still a predominant portion of the new acquisitions and constructions."

And the impact of the recently released, which mandates steep cuts in carbon emissions from U.S. power plants, could coax many Clean Power Plan coal-heavy utilities to gobble up gas-fired assets. Southern CEO Tom Fanning admitted that the regulations influenced the company's decision to make the AGL Resources acquisition.

"The Clean Power Plan will certainly create a lot more opportunities for development of gas-fired facilities, as well as renewable generation facilities," K&L Gates LLP partner Eric Freedman said.

Yieldcos Ran Out of Clean Energy Purchasing Power

When it came to M&A activity in the renewable energy sector, yieldcos were swinging the biggest checkbook for much of 2015.

Yieldcos are formed to house operating power generation assets that produce a consistent cash flow and high investor payouts. For renewable energy firms, forming yieldcos seemed like an ideal way to cash in on the utility-scale projects they were developing and use the money to fund additional project development.

Companies including merchant power giant NRG Energy Inc. and clean energy heavyweight SunEdison Inc. set up yieldcos and stuffed them with billions of dollars' worth of generation projects they either acquired or developed themselves.

In 2015 alone, SunEdison's yieldco TerraForm Power Inc. paid Invenergy Wind LLC $2 billion for seven wind farms in the U.S. and Canada, $350 million for five wind farms from Atlantic Power Corp. and $922 million for Vivint Solar's project portfolio, part of SunEdison's $2.2 billion acquisition of the rooftop solar firm.

"Everything has been driven primarily by the appetite of the yieldcos," Stoel Rives LLP partner Ed Einowski said. "The downside of the trend is that the pressure on people trying to feed the yieldco has probably inflated the prices of projects."

That led to yieldco stock prices tanking in the second half of 2015, as investors feared there were too many yieldcos chasing too few projects.

That's put the companies in a financial squeeze on yieldcos, which means they're no longer in a great position to purchase projects while maintaining their promised returns. With the most aggressive bidders for clean energy assets now out of the market, prices are starting to come down, attorneys say.

"It's been a pretty dramatic change in fortune," Freedman said.

--Editing by Katherine Rautenberg and Patricia K. Cole.
