



Bridging the Bid-Ask Spread in the Oil Patch

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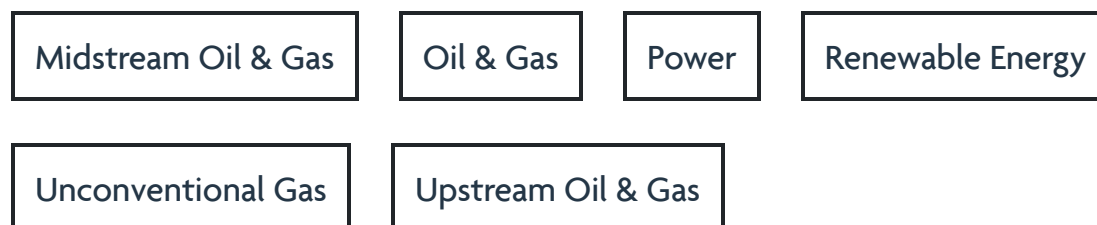
All-cash transactions, which have historically dominated the upstream M&A landscape, certainly do not facilitate a further narrowing of this bid-ask spread. On one hand, sellers are concerned that they will sell low and miss out on value associated with the eventual price rebound. On the other hand, buyers may potentially be more pessimistic than their counterparts on the timing of the rebound. In this environment, where buyers and sellers often still do not see eye to eye, many are actively considering mechanisms, such as earnouts, to help bridge the gap.

The simplest form of an earnout in an upstream transaction is linking post closing payments to the magnitude and timing of the increase in commodity prices. This mechanism alleviates concerns with respect to both sellers and buyers: the former because they can now participate in a portion of the upside and the latter because additional consideration is due only if the price rebounds in line with agreed-upon parameters.

While an earnout presents the parties with a potential avenue to align expectations with respect to a price rebound, financial sponsors should carefully consider how an earnout might impact other aspects of the transaction. For example, a buyer concerned about the financial ability of a distressed seller to backstop its indemnification obligations could negotiate that earnout payments owed to the seller are offset against indemnification payments owed to the buyer. Buyers hiring key employees to continue to operate the oil and gas assets should also consider whether such employees need to remain with the assets as a condition precedent to earnout payments being made. While such other considerations may potentially result in an earnout structure more complex than what parties had originally envisioned, a

carefully constructed and well-drafted mechanism can provide both sides with the assurance and flexibility that is often required to get a deal signed in this uncertain market.

Categories



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