

ENERGY EXPERT: ISSUES IN FOCUS

A quarterly review of disputes and complex issues in the hydrocarbon production and processing industries.

Baker & O'Brien, Inc.

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When a Refinery Joint Venture Ends in “Divorce” – What are the Assets Worth?

UNCITRAL Arbitration, Europe

By Kevin G. Waguespack

Refining joint ventures (“JVs”) involving crude oil producers and refiners are not uncommon in the oil industry, especially when synergies exist that provide the JV with competitive advantages. However, when such advantages go unrealized, resulting in sustained periods of poor profitability, disagreements between the owners can often emerge. Such was the case involving a JV established in Eastern Europe, which resulted in the refining partner unilaterally terminating the JV agreement and taking over full control of the facility. The upstream partner subsequently filed an arbitration claim to recover what it believed to be its fair share of the refinery’s value. The matter was heard before an arbitration panel under UNCITRAL rules in The Hague.

Baker & O’Brien was engaged to provide an opinion as to the fair market value of the refinery at or around the time of the dissolution of the JV. Our consultants visited the refinery to interview key management personnel, view the physical facilities, and gather relevant operational, maintenance, and financial information. We then prepared value estimates based on projected future cash flows, recent comparable market transactions, and the depreciated cost of

replacement—the three standard methodologies typically applied in such appraisals.

However, several issues made this valuation somewhat more complicated than typical, including: (1) various private blocks of shares in the enterprise had been transacted at or around the date of the JV’s dissolution, but it was difficult to ascertain whether these were true “arms-length” transactions; (2) a number of refineries in the country had previously closed due to intense competition from a highly-subsidized regional refinery, lending difficulty to any accurate prediction of future cash flow; (3) relatively little maintenance capital had been invested in the facility in recent years, raising questions about reliability and causing gasoline and diesel quality to be outside international standards; and (4) the refinery’s distribution costs were unusually high due to the absence of any pipeline infrastructure.

Notwithstanding these challenges, we consolidated our value opinions, submitted two expert reports into evidence in the arbitration, and our lead consultant testified regarding our findings before the UNCITRAL arbitration panel.



Dissecting the Root Cause of Equipment Failure – Was the Hurricane to Blame?

Arbitration, United States

By J. David Morgan

When a Category 5 hurricane swept through the U.S. Gulf Coast, a petrochemical plant was forced to shut down and suffered equipment damage. The owner filed an insurance claim for business interruption and property damage. The plant is supplied with utility steam from an adjacent refinery, which also suffered damage during the hurricane. Several months after the hurricane, the petrochemical plant suffered another shutdown—and additional losses—when three of the adjacent refinery's boilers failed and the steam supply was disrupted. A statistical analysis of the refinery's steam system revealed a much higher boiler failure rate following the hurricane, leading the petrochemical plant owner to conclude that the economic damages suffered during the second shutdown should be included as part of the original hurricane insurance claim.

Although statistical analysis of equipment performance can be useful in analyzing trends and characteristics associated with equipment failures, such studies can be misleading when trying to identify the “root” cause of a specific failure event. Only detailed analysis of an individual equipment failure can serve to ascertain whether any common

degradation mechanisms or events may have contributed to the failure, and identify the root cause.



Baker & O'Brien was retained to conduct such a detailed analysis of the failure events associated with the refinery's three boilers that caused the steam supply disruption. Our objective was to express an opinion as to whether each failure was hurricane-related or whether it was due to other unrelated cause(s). Our findings and opinions were presented in a report which was submitted into evidence. During a subsequent meeting between the claimant and the respondent, the case was settled.

Prelude to Arbitration?

Contract Dispute, United States

By Dileep N. Sirur



A producer of a high value petroleum-derived product entered into a multi-year contract with a large buyer who used the product in a derivative manufacturing operation. Under the contract's pricing provision, the producer agreed to notify the buyer each year of next year's "Market Price," which was defined as, "...the average price charged by other United States producers for comparable product for delivery in North America."

In one year, the producer notified the buyer of a substantial increase in the Market Price—which the buyer objected to as being above that referred to in the Market Price definition. Because at the time of the dispute, there was only one other North American producer of comparable product, the contractual Market Price was, in effect, the average price charged by this second producer to its North American buyers—of which there were only three. The buyer filed an arbitration claim under the contract.

The contract's arbitration clause required, prior to the convening of the panel, that the parties engage an oil industry expert to undertake an independent assessment of the contractually-defined Market Price. Such assessment would rely on confidential pricing information from both parties, as well as from the three North American buyers. Baker & O'Brien was named as the industry expert and our activities were coordinated by the international arbitration commission. If both parties were willing to accept it, the price we determined would be the following year's Market Price, avoiding the costs of arbitration.

Using the confidential information provided, along with other information uncovered through online research and other sources, we were able to establish the price which, in our opinion, best fit the Market Price definition, and a report was submitted to the commission. The parties used our report in a decision on how to resolve the matter.

Consulting Support for Complex Commercial Disputes

When faced with complex commercial disputes in the energy-related industries, clients often turn to Baker & O'Brien for its independent and objective support. For over 20 years, the firm's consultants have employed their engineering knowledge, industry experiences, and commercial acumen to provide assistance on a wide range of matters. Our project experience includes disputes involving operational incidents, standards of care, asset valuation, commercial supply terms, product quality, large engineering and construction projects, and intellectual property.

Our clients include many of the world's largest law firms, insurance providers, and operating companies. Law firms rely upon Baker & O'Brien to evaluate

technical and commercial aspects of a case and provide expert testimony. Our analyses, conclusions, and expert testimony have been heard by judges, juries, and arbitration panels around the world. On insurance matters, clients rely upon Baker & O'Brien's assistance for investigation of industrial accidents, and quantification of resultant property damage and business interruption losses. We are also called upon to assist insurers in subrogation actions by evaluating causation theories and claims for damages.

We would welcome the opportunity to discuss our qualifications in more detail as they relate to your specific area of interest.

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