H.S. Grace & Company, Inc.

Breach of Contract & Damages: Two Energy Cases

With the significant shifts in energy prices over the last year, investor-related lawsuits are on the rise in the energy industry. See *The Wall Street Journal*, January 15, 2009, "After the Oil Boom, a Gusher of Investment-Fraud Cases." H.S. Grace & Company, Inc. (HSG) has a broad range of experience both in analyzing energy investment agreements and relationships and in determining damages potentially arising from investment decisions. HSG has served as an expert witness in numerous energy industry disputes involving an array of energy industry participants and their directors and officers, including, oil and gas exploration companies, wholesale electric suppliers, offshore refineries, crude oil transporters, and power generation facilities. These disputes have involved issues relating to exploration and development agreements, energy financing arrangements, purchase and sale agreements, power generation blackouts, drilling rig construction contracts, and bankruptcy-related issues. The following two recent HSG cases demonstrate how HSG's experience in both energy-related matters and in financing arrangements can prove instrumental in examining and analyzing complex energy transactions.

Breach of Letter Agreement and Operating Agreement

Allegations

Plaintiff ABC oil company sued defendant XYZ oil company (HSG client) under a letter agreement and operating agreement involving the purchase and subsequent operation of an oil field. ABC contended that XYZ, the operator, had intentionally hindered ABC's efforts to participate in development of the field by various actions, including failure to provide access to data, in breach of both the letter agreement for purchase of the field and the operating agreement. ABC asserted that the resulting delay in development of the field allegedly caused by XYZ's actions had injured ABC by lowering its stock price in a subsequent public offering. HSG was retained by XYZ to analyze these allegations and the damages calculated by ABC's expert.

Analysis

The HSG team consisted of four senior executives with energy-related experience. Using available information on the financial condition of XYZ and drawing on their extensive knowledge of the oil and gas industry and financial experience in damage calculation, the HSG team concluded:

1. ABC oil company was in dire financial straits and was not capable of financing the proposed development program;

2. Defendant XYZ oil company had operated in a manner that benefited both ABC and XYZ.

3. Plaintiff expert's stock pricing model damage calculation based on historic cash flows violated generally accepted valuation techniques and ignored accepted factors used in valuation, e.g. the timing and amount of future cash flows.

Result

A satisfactory settlement was reached after extensive discovery.

Breach of Loan Agreement and Agreement to Provide Remediation Services

Allegations

Plaintiff Private Investor and defendant U.S. Oil Company (HSG client), the owner of a major oil field in Indonesia, entered into an agreement pursuant to which Private Investor agreed to fund and provide remediation services for the field and to loan money to U.S. Oil company for purchase of an oil storage vessel. Private Investor subsequently sued U.S. Oil Company for moneys allegedly due under the loan agreement and for possession of the crude oil storage vessel under the terms of a collateral marine agreement. U.S. Oil Company counterclaimed contending that Private Investor had materially breached the loan agreement by failing to fund and provide the remediation services. U.S. Oil Company retained HSG to investigate the allegations and to analyze the economic damages suffered by U.S. Oil Company as a result of Private Investor failure to fund and provide the remediation services, which would have resulted in substantial increased production from the field.

Analysis

The HSG team included the former CFO of a major oil company, a former chief credit officer of a major European bank, and the former treasurer of one of the world's largest port authorities. The team found:

1. Private Investor appeared to have intentionally breached its obligations to fund and provide remediation services to U.S. Oil Company so that U.S. Oil Company would be unable to repay its loans in a timely manner. Private Investor did this in an effort to force U.S. Oil Company to sell the field to Private Investor at a diminished price.

2. U.S. Oil Company was damaged by Private Investor's failure to provide the agreed upon funding and remediation services;

3. U.S. Oil Company's damages included two components, i.e. lost production revenues through the date on which U.S. Oil Company sold a majority interest in the field to a third party and the diminution in the sale price of the field upon the sale to the third party.

4. Using Private Investor's estimates of increased production from the field to be achieved by the remediation operations, HSG calculated a range of damages at various production levels, oil prices, and capital costs.

Results

A satisfactory resolution was reached after expert reports were filed.

H.S. Grace & Company, Inc. is a team of senior executives who diagnose and resolve critical corporate problems in business governance, operations, finance and control. With more than 1,000 years of experience, our goal is to help companies enhance shareholder value, protect reputation and their long-term ability to succeed, avoid and manage litigation, and navigate major changes such as mergers and acquisitions or bankruptcies. We often serve as consulting and testifying experts, identifying and analyzing critical business issues.

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