

Consolidation is the next step when market conditions limit growth. Even now, lawyers report that activity among junior companies — especially gas producers — is high, as firms get defensive, jockey for position and look for ways to survive.

M & A

JUNIORS POISED FOR MERGERS

LEGAL BONANZA

By JIN MIDDLEMISS

Alberta's junior oil and gas sector is poised for a flurry of merger and acquisition activity in the coming months — and that spells good news for Canadian law firms.

The changes could fundamentally restructure the junior energy business and create a new middle tier of oil and gas exploration companies from those that were virtually wiped out in an income trust-dominated market, say lawyers.

Behind the shake-up is a combination of low gas prices and high wage costs, combined with the end of income trusts — the traditional exit strategy for juniors — and uncertainty around the impact of the new royalty regime. M&A activity could heat up as early as this month as juniors announce their quarterly reports and lenders evaluate the borrowing capacity of those issuers," said Bill Guinan, a partner in the Calgary office of Borden Ladner Gervais. He said the current market conditions are such that they can limit growth. "When that occurs, consolidation is the next step."

Even now, lawyers report that activity among junior companies — especially gas producers — is high, as firms get defensive, jockey for position and look for ways to survive. "We're seeing a ton of that right now. It's very active," said Bob Lehodey, a lawyer at Osler, Hoskin & Harcourt's Calgary office.

But not all deals will go through, he said. "There's been a lot of transactions that falter once they get some legs because people don't talk about the soft issues in an M&A."

By soft issues, he means "people issues," such as who is going to run the company and how will the management teams integrate. "Most of the small companies have a controlling or large influential shareholder who usually wants to have their say at the end of the day."

Juniors are usually run by headstrong entrepreneurs, and it can be difficult to join such companies because of the strong personalities. However, something has got to give, he said, noting that small companies, those with production of 800 to 1,500 barrels of oil a day, "don't have enough cash flow to continue their capital investment to maintain their production levels."

Oil and gas wells produce

and decline every day, so firms constantly need to add to their reserves by either buying some or finding more. However, when prices are low and costs are high, it makes it difficult. Toss in higher royalties and a credit crunch, in which banks are loath to lend, and it only adds to the turmoil.

One thing playing in favour of gas companies is the fact natural gas prices have firmed up lately. But it could be futile. Mr. Lehodey said there is a "massive number of small companies who are faced with the triumvirate [of events]."

Don Greenfield, a partner at Bennett Jones in Calgary, agrees that "we're seeing more M&A activity because some of the gas producers are finding themselves strapped for cash or unable to continue their growth curve."

While the firmer prices have helped, there are "still some companies that are hurting and are being put in play or putting themselves in play because of both gas prices and the impact of the royalty rates."

Greg Turnbull, a lawyer with McCarthy Tétrault in Toronto, said the royalty concern means that "a lot of companies are moving their budgets away from Alberta to British Columbia and Saskatchewan." However, those remain largely

Alberta-based companies, so the financing work likely remains with Alberta law firms.

He said it is a "short-term response to the royalty change." Part of the problem is that the changes treat high-productivity wells more harshly and essentially penalizes those who take the greater risk. He believes the government will recognize the folly of that and adjust the scheme to face the "economic realities of the situation."

Grant Zawalsky, a lawyer at Burnet Duckworth & Palmer in Calgary, said "it's a very funny time in the industry." It's common to have some companies struggle and fail — "that's not outside the norm" — but he notes "things are very slow despite tremendously good commodity prices. It's a very difficult time for juniors; a lot of them haven't figured out what they are going to do."

It hasn't helped that a number of income trusts spun off small exploration companies when they trusted out, and now that trusts will be shut down in 2011, an exit strategy has been eliminated for the juniors, which would normally grow to a certain level and sell their production, then do it again.

However, the lawyers say new trust rules means those organizations will have to review their strategies, and many will convert to companies and move away from passive overseers of assets to aggressive exploration-and-development strategies.

Mr. Lehodey said, "we're going to have a recreation of that space again," meaning the middle-tier oil and gas exploration company. "The opportunity exists for someone to buy out income trust" and get that ball rolling.

Financial Post
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ISSUER
LEGAL COUNSEL

Canadian Legal Counsel to Issuer on Public Offerings by Oil & Gas Producers during 2007	Value of deals in \$Millions	Rank by value	Number of deals	Rank by number of deals
Macleod Dixon LLP	3,584.33	1	10	2
Parlee McLaws LLP	2,961.99	2	2	18
Burnet, Duckworth & Palmer LLP	2,512.26	3	23	1
Bennett Jones LLP	2,426.88	4	7	3
Blake, Cassels & Graydon LLP	2,091.96	5	6	6
Borden Ladner Gervais LLP	903.20	6	2	10
McCarthy Tétrault LLP	831.20	7	7	3
Gowling Lafleur Henderson LLP	687.46	8	2	10
Osler, Hoskin & Harcourt LLP	506.66	9	5	7
Stikeman Elliott LLP	487.16	10	5	7
Burstill Winger LLP	269.60	11	7	3
Davis LLP	122.54	12	2	10
Heenan Blaikie LLP	75.15	13	2	10
McLeod & Company LLP	72.00	14	1	15
DuMoulin Black LLP	62.23	15	3	9
Aird & Berlis LLP	40.00	16	1	15
Fasken Martineau DuMoulin LLP	2.41	17	1	15
Tingle Merrett LLP	1.15	18	1	15
Besjardins Ducharme, LLP	1.15	19	1	15
Joanne S. McClusky	0.51	20	1	15
Carscallen Leitch LLP	0.50	21	1	15

UNDERWRITER
LEGAL COUNSEL

Canadian Legal Counsel to Underwriter on Public Offerings by Oil & Gas Producers in 2007	Value of deals in \$Millions	Rank by value	Number of deals	Rank by number of deals
Blake, Cassels & Graydon LLP	2,734.69	1	15	1
Burnet, Duckworth & Palmer LLP	2,476.58	2	11	2
Stikeman Elliott LLP	1,521.44	3	10	4
Macleod Dixon LLP	1,482.89	4	11	2
McCarthy Tétrault LLP	1,202.04	5	8	6
Bennett Jones LLP	935.67	6	10	4
Fraser Milner Casgrain LLP	850.49	7	5	7
Borden Ladner Gervais LLP	260.79	8	2	9
Burstill Winger LLP	113.90	9	5	7
Heenan Blaikie LLP	95.47	10	2	9
Gowling Lafleur Henderson LLP	70.00	11	1	11
Wildeboer Dellelce LLP	40.00	12	1	11
Osler, Hoskin & Harcourt LLP	15.06	13	1	11
Miller Thomson LLP	8.50	14	1	11
BCF LLP	2.30	15	1	11
McCullough O'Connor Irwin LLP	0.51	16	1	11
Tingle Merrett LLP	0.50	17	1	11

SOURCE: IY DATAGROUP

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