

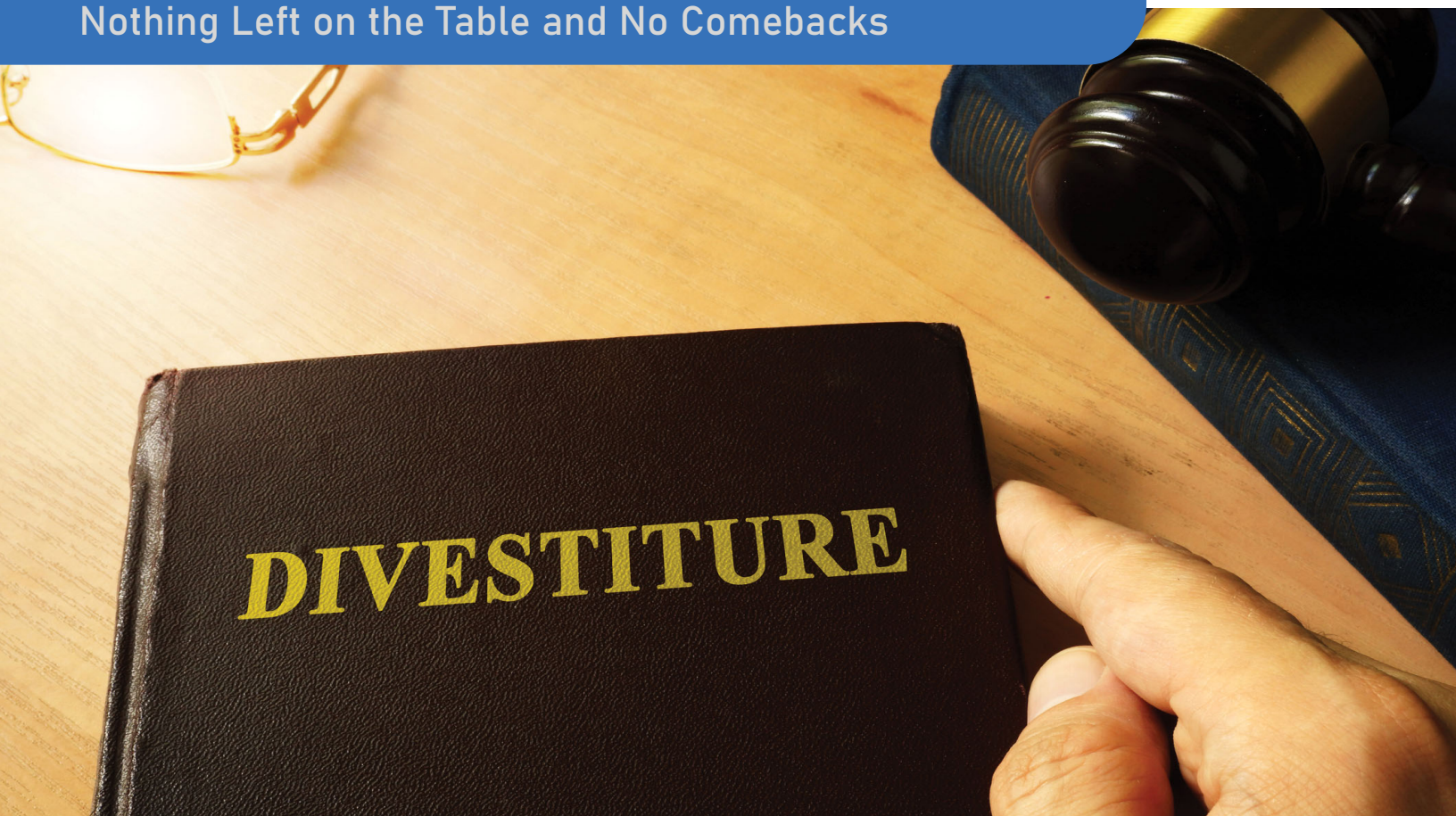
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THE PERFECT DIVESTITURE:
Nothing Left on the Table and No Comebacks



PILKO & ASSOCIATES GREY PAPER

Concise summaries of key Operational/EHS and Transaction Risk challenges and how to unlock value for your organization

Pilko & Associates is the Leading Advisor to Corporate Officers and Boards on Operational and EHS Risks – working with clients in 78 countries and advising on M&A deals worth more than \$600 billion.

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EXECUTIVE SUMMARY

Divestitures bring about a transfer of ownership, often for extraordinary sums of money. Identifying all parameters plays a critical role in determining a successful transaction. This blueprint serves as a guide for sellers and buyers, highlighting specific points that should be considered.

The 4 Pillars to Divestiture Success

1. Operational and EHS Guidelines
2. Scope and Boundaries
3. Ownership
4. Negotiations

This Grey Paper will expand on each of these pillars in detail.

CONTROLLING THE PARAMETERS TO ENSURE DIVESTITURE SUCCESS

By utilizing the **4 PILLARS** listed above, business leaders can effectively manage divestiture proceedings by asking **4 CRITICAL QUESTIONS**:

1. What operational and EHS considerations will impact the divestiture process?
2. How should the seller define disclosure boundaries before soliciting potential buyers?
3. How is the ownership of operational and EHS responsibilities assigned in the actual sale?
4. How are operational and EHS liabilities identified, compartmentalized, and mitigated in the data room during negotiations?

For a complete transfer of ownership, the identification and description of all operational and EHS considerations must occur early in the deal.

Critical Operational and EHS Considerations

An asset's operational and EHS performance are pivotal as they directly influence value; therefore, when negotiating a divestiture agreement, significant emphasis should be placed on these assessments. From a functional perspective, the agreement should highlight reliability as the level of maintenance directed at an asset defines its life span. When describing EHS considerations, parties must pay attention to past spill incidents and remediation expenditure and identify violations associated with uncontrolled releases to air and soil. Both incidents and violations directly influence the attractiveness of the assets for sale.

In addition, a Material Issue Briefing should identify significant reliability and EHS concerns that impact deal valuation. Depending on the scale and value, liabilities can be passed to potential buyers or removed from the sale or covered under indemnities from the seller.

To increase the likelihood of a successful sale, the seller can draft a Vendor Due Diligence Report, but often questions arise about what data to include. Information supplied to bidders by the seller should be accurate, positive, and consistent.

Operational and EHS components make up the asset's DNA. While highlighting attractive features is important, the seller is responsible for disclosing unattractive characteristics as well. By placing the "warts and all" at the front end and offering proposals for mitigation, the seller escapes potential disclosure and liability concerns in the future.

Establishing Healthy Boundaries

While historically divestiture agreements subscribed to the "As Is, where is" sale blueprint with minimal disclosure, the game has drastically

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changed. With risk and liability driving business decisions, sellers achieve better success with full disclosure.

Attraction of multiple bidders can create a contested auction and help to drive up the selling price; and greater disclosure can get more bidders comfortable when they fully understand the risks and liabilities involved. To achieve this situation, the seller should think carefully about the appropriate threshold of materiality that will filter what information to disclose.

The seller must be honest with potential buyers but avoid flooding reports with minimalistic data that bears no significant budgetary impact.

A careful balance must be maintained so buyers do not feel aggrieved that they have been misled.

The seller must consider all reasonable courses of action. While some of the disclosure might not favorably impress the buyer, the seller does have the recourse to describe mitigation options. Committed to an honest sale to ensure no comebacks, the seller can offer alternative action, such as indemnity clauses, for less attractive items. Either seller or buyer can solicit a representation and warranty insurance policy to provide third party coverage if contractual language fails to offer an acceptable solution.

Assigning Ownership

After establishing boundaries, a divestiture can proceed. The seller and buyer must effectively manage each item of interest previously listed with negotiations conducted to establish risk ownership. Each element of the deal carries specific liabilities. With the transfer of ownership, the liability may also transfer, or does it have to?

It is not immutable that each liability must transition with the asset. Instead, the seller can decide to carve out issues and continue to manage the liability.

Legacy issues may be relevant. While an asset may appear attractive, it could have been patched up after surviving a catastrophic event. What looks good now might still harbor unmitigated risks from

gaps in lessons learned. If operation of an asset triggered some violation, such as a significant loss of primary containment resulting in an environmental spill, the seller likely incurred fines. After bringing the asset up to acceptable operating standards, the prior fines and penalties levied still apply as does the reputational impact.

A seller may have residual liabilities, which should be disclosed in the data presented to buyers. This disclosure ensures no exposure is created that could create the opportunity for comebacks.

The key to avoiding comebacks is the seller's commitment to being accurate, thorough, and consistent in the information presented.

DATA ROOM DELIVERABLES

Consistency is pivotal when planning and implementing a successful divestiture. The seller must clearly present evaluation and assessment to potential buyers, making the Virtual Data Room (VDR) the focus of scrutiny for buyers before any site visits.

The Vendor Due Diligence (VDD) Report is posted in the Data Room to provide all relevant information. The key to avoiding comebacks is the seller's commitment to being accurate, thorough, and consistent in the information presented.

Divestitures attract two different categories of buyers.

- ▶ **Strategic buyers** typically search out assets for long-term investment, so describing how the asset has performed over time is critical, as well as how long it will continue to be economically viable into the future.
- ▶ **Private equity firms** searching for attractive acquisitions look for a quicker turnaround. As a result, the asset appears more attractive to this type of buyer if it is free from EHS issues with scope for cost reduction and growth opportunities.

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In addition to promoting the highest valuation, the VDR serves as the backstop for presentation of information, validated by site visits and management presentations. **Success in achieving a high-value sale can be substantially undermined** if the buyer returns to the table a year later, making material allegations of a misrepresented sale.

The Data Room allows the seller to present fair, accurate, and consistent information so the buyer can confidently make an informed decision without post-acquisition regret. The more accurate the information made available in the Data Room, the more the seller has robust assurance that the divestiture will not be exposed to the risk of comebacks in the future.

The Data Room allows the seller to present fair, accurate, and consistent information so the buyer can make an informed decision without post-acquisition regret.

PROCEED WITH CAUTION

With any divestiture, the seller should aim to be held harmless when looking at the transaction from both a financial and liability perspective. Taking the time on the front end can avoid future retribution clawing back significant value.

Many historical examples exist of inadequate disclosure coming back to haunt the seller. Historical experiences offer the opportunity to gain valuable learnings from past mistakes. The seller would be much better off in the future addressing environmental pitfalls and other issues by dealing with them at the time of occurrence. Investing money in an asset being held for sale is often difficult to justify. Still, when considering the long-lasting ramifications, the upfront corrective investment usually proves to be the better option.

Companies often find themselves trapped in indecision when they are unclear whether the

priority is to “save” the asset or negotiate transfer to another owner who can identify more value or synergies with their existing business. By not devoting time to properly prepare before going to market, sellers find themselves up against time pressure and make sub-optimal decisions during the transaction process.

SUMMARY

A divestiture involves the transfer of an asset or business from the seller's to the buyer's portfolio; and on transition, the parties should be clear about what services, obligations and liabilities are going with the asset/business. Ownership includes specified elements of the deal associated with the asset. A clear path to ownership avoids uncertainty, ambiguity, and lingering risks.

For a complete transfer of ownership, the identification and description of all operational and EHS considerations must occur early in the deal. Consistent and thorough research allows the seller to create a detailed Vendor Due Diligence Report to properly communicate all components to potential buyers.

Disclosure is critical; and by establishing scope and boundaries, the seller can confidently communicate these aspects to prospective buyers. Being transparent and decisive ensures the buyer understands what elements accompany asset ownership.

The seller must establish these parameters before they are presented in the Data Room. Confusing and frustrating potential buyers with insignificant or irrelevant information can stall the sale process. A seller can best achieve a contested auction by ensuring clear disclosure that helps maintain a taut timeline.

At the same time, the seller can remain confident in a successful sale with **no fear of cramdowns** late in the Sale and Purchase Agreement (SPA) negotiation or threat of comebacks after the deal closes.

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ABOUT THE AUTHOR



Sven Royall is Pilko's Managing Director of Transaction Services with over 40 years of experience in Energy and Chemicals operations and major transactions. Mr. Royall's expertise was developed over a 34-year career in Shell's Chemicals and Natural Gas businesses, during which he

retained Pilko on several occasions to advise on important strategic reviews.

As the head of Pilko M&A, Sven has led Operational and EH&S due diligence for buy and sell side clients, establishing scope boundaries and levels of materiality, reducing deal complexity by identifying and quantifying major risks, providing options for risk mitigation, and guiding clients during negotiations.

During his career, Sven has worked from London and Asia-Pacific with postings in Thailand, Malaysia, and Singapore where he developed in-depth experience in international deal-making. As the Director of the Base Chemicals business, he also worked for two years in Houston. In Malaysia as the commercial director for start-up of the first Gas-to-Liquid (GtL) plant, he developed global markets for a range of ultra-clean fuels. Finalizing his career with Shell, Sven was EVP for Chemicals responsible for Strategy, EHS and External Affairs, and also responsible for Commercial Operations, M&A and Ventures.

Sven has worked as a board member for many joint ventures (JVs) in Europe, the Middle East (including the Sadaf JV with SABIC), Asia-Pacific and North America (as Chair of the Catalyst business).

For six years he was chairman of the Infineum additives JV and, with Pilko's assistance, conducted

a strategic review of the business (jointly with ExxonMobil). As lead director, Sven was responsible for several JV divestments, including Basell (jointly with BASF). His wider industry experience has come from the CEFIC Board in Europe as Chair of the Product Stewardship Programme Council during the introduction of REACH and subsequently on the American Chemistry Council Board as Chair of The Responsible Care Committee.

ABOUT PILKO & ASSOCIATES

Pilko is the Leading Advisor to Corporate Officers and Boards on Operational and EHS Risks in the energy, chemical and related industries, with a vision of transforming operations to be the safest, most reliable, and sustainable.

We help Clients solve their toughest challenges by identifying and mitigating Operational and EHS risk. We advise Clients on Driving Rapid, Dramatic and Sustainable improvement in Operational and EHS performance, as well as advise on mergers, acquisitions, divestitures, and major projects. Pilko Advisors are always brutally honest but respectful.

Throughout 2024-25, Pilko is celebrating our 45th year as a trusted advisor to senior leaders in the energy, chemical, and related industries. The Pilko journey, spanning nearly half a century, has been enriched by each relationship we've built and every project we've undertaken.

This milestone is a significant testament to the outstanding expertise, knowledge, and practical perspective of our team, as well as the trust and loyalty of our clients and partners.

To learn more about developing a world class approach to managing risks, email us at greypaper@pilko.com or contact us at pilko.com.

