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Noisy prenuptial fight erupts between pipeline companies

Williams Cos. says Energy Transfer executives are violating their merger agreement

By Robert Grattan April 6, 2016 Updated: April 6, 2016 11:39pm

The $37 billion merger of the Williams Cos. and Energy Transfer Equity has turned into an all-out battle that on Wednesday landed in court.

Tulsa-based pipeline giant Williams sued Energy Transfer, alleging that its managers were trying to enrich themselves at the expense of shareholders in violation of the merger agreement. The lawsuit seeks to halt a private placement of 329.3 million preferred shares that would go largely to Energy Transfer's executives.

Some observers say Williams would like to avoid paying a $1.5 billion breakup fee. Others say Dallas-based Energy Transfer has been trying to blow up the deal.

"Energy Transfer is doing everything short of sprinkling broken glass outside of company headquarters to tell Williams not to come in," said Stewart Glickman, who follows both companies for S&P Capital IQ.

Officials from both companies declined to comment beyond the statements they issued regarding the lawsuit.

The deal was a coup for Energy Transfer when it was inked in September after a long courtship of Williams. The merger was hailed as a way to create the largest and one of the most diversified pipeline companies in the U.S. The companies also outlined more than $2 billion in pretax earnings that would result from stitching together the two networks of pipelines.

But low oil prices soon added pressures to the deal. Stingy capital markets have since made the $6 billion in cash promised to Williams by Energy Transfer tough for shareholders to swallow, Glickman said, and Williams has struggled as one of its largest customers, Chesapeake Energy, has tilted toward bankruptcy.

In March, Energy Transfer CFO Jamie Welch, who helped design the merger, called shareholders of Williams and urged them to vote against the deal, according to both the lawsuit Williams filed Wednesday and reports in the New York Times.

Welch was fired in February, and he is suing his former employer for breach of contract. His departure sent shares Energy Transfer shares tumbling after it was announced in a regulatory filing.

Then in late March, Energy Transfer lowered its expectations for the deal, saying that the benefit from buying Williams would be only $170 million in annual pretax earnings. The company called the new figures "materially less" than the $2 billion it had used to headline previous announcements.

Energy Transfer has also said it plans to "significantly reduce" its workforce across Oklahoma if the deal goes through, which has prompted an outcry from workers and elected officials.

The breaking point, and the focus of Williams' lawsuit filed Wednesday, appears to have come after Energy Transfer issued 329.3 million preferred shares on March 8.

The deal has had some analysts scratching their heads and Williams executives outraged.

"In more than 30 years of managing money, I've never seen a maneuver like the one Kelcy Warren pulled," Fredric Russell, an investment manager at Tulsa's Fredric E. Russell Investment Management Co., said of Energy Transfer's chief executive.

Williams had stronger words for the deal.

"Mr. Warren specifically designed the Special Offering to enrich himself as ETE's largest (shareholders) at the expense of other ETE common (shareholders)" as well as current Williams stockholders, the company alleged in its lawsuit.

Energy Transfer has responded in a regulatory filing.

"ETE believes that it has complied, and it intends to continue to comply, with its obligations under the merger agreement with Williams and intends to vigorously defend against the claims made by Williams," the company wrote.

The new shares offered investors a chance to forgo some dividends now in exchange for a larger payoff later. But the final payout from the shares is tied to the 28.5 cent dividend Energy Transfer's regular equity currently pays, even if that dividend is cut.

Warren purchased 187.3 million of the new shares, or about 57 percent of the total offered.

Timm Schneider, an analyst who follows the company for Evercore ISI, is forecasting that if the deal closes, Energy Transfer Equity would need to cut its dividend by as much as 75 percent through the first quarter of 2018. That money that the company didn't pay to investors would instead go to pay down debt.

In the news release announcing Williams' lawsuit, the company's board said it still supports the merger.

"Williams remains committed to working with ETE to ensure the financial strength of the combined company, provided that all ETE and Williams investors are treated fairly and equitably," the company wrote.

Under the terms of the merger, if Williams' board changes its position and urges its shareholders to vote against the deal, the company will have to pay a $1.5 billion breakup fee.

If, however, Williams shareholders decide to walk away from the deal on their own, Williams is on the hook for only about $50 million.

"The entire marriage or would-be marriage has become a very murky situation," Russell said.

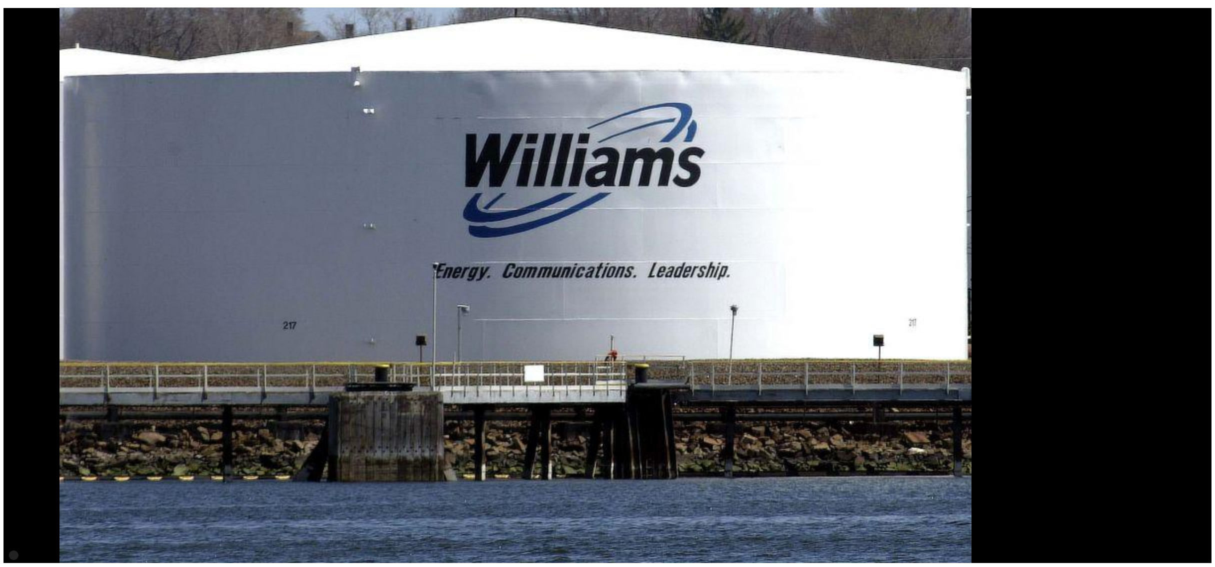

Photo: STEVEN E. FRISCHLING
IMAGE 1 OF 2
Pipeline heavyweight Williams alleges that Energy Transfer managers are trying to enrich themselves through their merger.

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IMAGE 2 OF 2

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