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**Comment: Errors and Omissions in the Report of the Examiner, The Freeh Group,  
regarding SemGroup, LP**

On April 15, 2009, the Bankruptcy Court Examiner, Louis J. Freeh, filed his Final Report containing his conclusions and opinions concerning the circumstances surrounding the bankruptcy of SemGroup. Although Thomas Kivisto has been denied access to the documentation and witnesses underlying the Examiner's Report, it is clear that the Examiner's analysis contains numerous errors and gaps. The Examiner's Report demonstrates an insufficient understanding of SemGroup's derivative hedging program, and it has all but ignored the roles and financial sophistication of the Company's lenders and investors, such as Bank of America ("BofA") and Riverstone Energy Group ("Riverstone"), or SemGroup's financial, accounting and legal advisors. The Examiner's Report is not an unbiased and balanced assessment of events underlying SemGroup's bankruptcy, but rather appears to be a targeted attempt to lay blame on SemGroup's former officers while shielding the Company's lenders, investors/management committee members, and investment banking advisors from liability. The following are just a few of the more noticeable errors and gaps in the Report:

**Cause of the Bankruptcy**

- SemGroup's bankruptcy was not caused by an unsound or speculative trading strategy, but rather by the unjustified and premature cancellation of SemGroup's credit line. The Report admits that SemGroup expanded rapidly through "profits realized from a successful commodities trading program (from 2000 to 2006)." Report at p. 4. But from late 2007 to mid-2008, the market for oil and gas commodities experienced abnormal volatility and prices—which the Report considered "unprecedented"—and oil prices reached an all-time high of nearly \$150 per barrel in July 2008. If BofA, the lead member of SemGroup's banking facility, had not precipitously pulled SemGroup's credit line without notice or warning, then SemGroup would have made large profits in the second-half of 2008 (as did Chesapeake, Devon and others with similar trading strategies),

thereby saving countless jobs. Likewise, the Report does not examine whether BofA (which had relatively minor exposure and priority in repayment) gave sufficient notice to the other lenders in the credit facility who might well have assumed BofA's role.

- SemGroup was forced to file for bankruptcy because BofA denied the Company further access to funds under its credit facility in July 2008. SemGroup was not in violation of its loan covenants at the time, and the Report does not address whether BofA breached its own obligations to SemGroup. The Report does not disclose whether Mr. Freeh is or has been on retainer from BofA, as media reports suggest, or Goldman Sachs. It is clear that at least BofA and SemGroup's unsecured creditors (unlike Mr. Kivisto and the other targeted former officers) had access to a draft of the Report before it was filed. It remains unclear what impact the prior review by these and other entities had on the content of the Report before it was filed. Finally, no individual from BofA is identified in the Examiner's Report; rather, the Report appears to cherry-pick quotes from anonymous BofA representatives (and Goldman Sachs, J. Aron and Merrill Lynch representatives – also anonymous). These unexplained gaps undermine the credibility of the Report.
- Despite media reports regarding potential “front-running” of SemGroup's trades by Goldman Sachs or one of its affiliates, the Report indicates that no investigation was undertaken. The Examiner thus did not consider whether, for example, Goldman Sachs and/or an affiliate, knowing all of SemGroup's trading positions and knowing that SemGroup's book was required to stay delta-neutral, then used that knowledge to move the market on NYMEX, thus compelling offsetting trades by SemGroup which Goldman Sachs could profitably exploit by taking the other sides of those trades. With SemGroup's delta-neutral trading policy, no trading strategy could account for this artificial market manipulation. In fact, the Official Committee of Unsecured Creditors has announced that it will now commence an investigation of the roles played by Goldman Sachs, J. Aron, BofA and others in SemGroup's failure.

### **Misunderstanding of Trading Strategy**

- The Report reflects a lack of knowledge or understanding of the economics of the crude-oil business, including the prudent combination of risk and return, which resulted in a basic misunderstanding of SemGroup's business model. Specifically, the Report demonstrates a lack of technical sophistication required to understand the energy industry and commodity markets, including such issues as risk-management practices, the manner by which energy prices respond during times of crisis, the ability of firms such as SemGroup to hedge their physical positions in financial markets, and the prudent risk-minimizing steps SemGroup

management took under the leadership of Mr. Kivisto in response to rapidly-changing circumstances.

- The Examiner failed to note there were other large and reputable energy firms with business models employing trading strategies similar to SemGroup's. They also experienced significant mark-to-market losses over this time period. One clear and public example is Chevron Corp. Although Chevron followed a similar trading model and also experienced trading losses over the first half of 2008, Chevron, unlike SemGroup, did not have its credit pulled at a crucial point, and was therefore able to weather the "unprecedented" storm of volatility and price increases.
- The Report's analysis of SemGroup's trading strategy is fundamentally flawed. For example, the Report states that its "analyses focused on options sales to the exclusion of options purchases because options purchases give the buyer the right, but not the obligation, to transact. As such, options purchases cannot create MtM liability." Report at p. 80. While this is correct regarding potential liability for sold options, the exclusion of purchased options from the analysis prevented the Examiner from determining whether SemGroup's derivative positions were delta-neutral (*i.e.*, whether the portfolio contains equal offsetting long and short positions in inventory and future supply) and therefore the overall prudence of the portfolio. This is a fundamental flaw in the analysis that renders useless any conclusion regarding the efficacy and reasonableness of SemGroup's trading.
- The Examiner failed to recognize that the overall book was a combination of positions on NYMEX (which were subject to margin calls) and bilateral Over-the-Counter (OTC) positions (which were not subject to margin-calls). In reviewing the exposure of each portion of the book on a stand-alone basis, the Examiner failed to recognize that the true exposure is the combination of those two positions.
- The Report claims that SemGroup engaged in a speculative trading strategy based on the philosophy that oil commodity prices would eventually revert to their historical mean. As noted above, SemGroup did not attempt to "call" the market; rather, it kept its trading book delta-neutral.
- SemGroup's losses on its trading book were mark-to-market, until BofA pulled SemGroup's credit and it was forced to novate the book to Barclays and therefore recognize the losses. The facts will show that Barclays' purchase was extremely profitable.
- One of the Report's most glaring omissions is its failure to give any credence to the multiple outside bank-sponsored evaluations and audits of SemGroup's trading program. Specifically, BofA hired two industry experts, James Bowen

and Evergreen Collateral Consulting to analyze SemGroup's trading program, including risk management rules and compliance. Their reports were made independently and at different times. Bowen's May 2007 report (Ex. 19 to the Report) finds that SemGroup's risk-management practices were "SATISFACTORY" and "exceeded common industry standards in several areas" (emphasis in the Report). Although Mr. Bowen noted areas for potential improvement, he concluded that none "is indicative of a need for concern." Mr. Bowen expressly notified BofA of SemGroup's large open market positions (comprising over 20% of the entire US market for three-month crude options), and the associated liquidity and margin risks. Further, while the Examiner disparages SemGroup's management of its margin requirements as reckless, BofA's own expert described SemGroup's efforts as "almost heroic" and "cutting-edge among the peer group." The Examiner does not appear to have interviewed Mr. Bowen or an Evergreen representative during his investigation.

### **Corporate Governance / Internal Controls**

- The Report criticizes SemGroup's corporate governance and internal controls in light of their purported deviation from unidentified and undefined "industry practice." Mr. Bowen, the expert hired by BofA, reported just the opposite to the Bank. The Report ignores that SemGroup is a private company with essentially three investors—Mr. Kivisto and two of the world's most sophisticated money managers. It is curious that the Examiner paints Riverstone—a hedge fund focused on energy investments that was founded by billionaire former Goldman Sachs executives—as an uninformed passive investor of SemGroup. The founders of Riverstone created the energy group at Goldman Sachs and were there more than 20 years before starting Riverstone. Riverstone performed extensive due diligence before choosing to invest in SemGroup in 2004. Riverstone controlled 1/3 of the seats on SemGroup's management committee. Riverstone fully understood SemGroup's trading strategy and bonus pool calculations. Surprisingly, the Examiner did not disclose why he chose not to interview the Riverstone founders who were responsible for Riverstone's due diligence investigation prior to its investment, and who served as members of SemGroup's management until 2006.
- The Report repeatedly criticizes SemGroup's Risk Management Policy ("RMP") because it supposedly does not satisfy "industry standards." But the Report fails to consider the fact that every investor (essentially, Riverstone and Ritchie Capital Management), as well as SemGroup's lenders, had reviewed and approved the RMP. Nor does the Report document any complaints about the RMP's purported inadequacy by SemGroup's investors or lenders in the years preceding the bankruptcy. As noted, BofA's own expert found that SemGroup's RMP was not only just satisfactory but in fact exceeded industry standards. The Report essentially ignores this independent analysis.

### Kivisto Smears

- The Examiner's Report misstates or misunderstands the SemGroup bonuses in an apparent attempt to smear Mr. Kivisto. Mr. Kivisto received only a portion of the bonuses to which he was contractually entitled under his written employment agreement (which was negotiated in 2004). Under his employment agreement, Mr. Kivisto was to receive an annual bonus from an executive bonus pool equal to 10% of SemGroup L.P.'s EBITDA. But Mr. Kivisto, and others, received bonuses from a much smaller pool—10% of EBITDA from only one division of SemGroup L.P. (*i.e.*, SemCrude). Moreover, Mr. Kivisto insisted that all SemGroup employees participate in the executive's bonus pool, including administrative staff and secretaries. The Company calculated bonuses under this simple formula for nearly 5 years with full disclosure to its financially sophisticated investors, outside auditors and lenders—without complaint.
- The Report criticizes Mr. Kivisto for his continued involvement with Westback Purchasing Co., LLC during his tenure at SemGroup. The facts, which the Examiner chooses to ignore, are that (1) Mr. Kivisto formed Westback years before SemGroup; (2) SemGroup was initially founded on and operated with credit line assistance from Westback and another Kivisto-related entity, Eaglwing—SemGroup never could have existed without Westback's and Eaglwing's early financial assistance; (3) Westback, without compensation, provided SemGroup with the assured option of purchasing at least 16,000 committed barrels of oil per day—almost 25% of SemGroup's entire daily outright production flow in 2008; (4) the value of Westback-directed production flow to SemGroup has been estimated at approximately \$20,000,000 per year; (5) Mr. Kivisto's business relationship with Westback was disclosed in the Company's financial statements and bond offering memoranda; and *most importantly* (6) Mr. Kivisto's employment agreement expressly permitted him to continue Westback's operations. The Report contends that SemGroup's outside auditors and lawyers had issues with SemGroup's trading with Westback, yet there is no indication in the Report that these accountants or lawyers raised concerns to anyone at SemGroup or its management committee. No outside lawyer or auditor is reported to have even been interviewed let alone quoted to support these accusations. In fact, SemGroup's outside auditors drafted the related-entities disclosure in SemGroup's offering memoranda and financial statements.
- The Report concludes that SemGroup improperly paid millions of dollars to Westback, but it failed to determine the nature and purpose of those payments. Had the Examiner properly considered the issue, he would have realized that ConAgra — for years SemGroup's OTC trading partner — had accounts with both SemGroup and Westback, but ConAgra combined both entities' trades under

- one account for settlement purposes. Thus SemGroup received payments from ConAgra for the settlement of Westback trades, and SemGroup properly transferred those funds to Westback. Likewise, SemGroup and Westback both made OTC trades with a Vess entity, and as with ConAgra, SemGroup received payments that were in settlement of Vess trades and properly passed the funds along to Vess.
- The Report makes numerous false implications regarding Mr. Kivisto's purported improper use of SemGroup resources. The truth is that (1) SemGroup never owned an airplane, but rather had time share contracts for the use of airplanes owned by others. Mr. Kivisto reimbursed SemGroup for any personal use of SemGroup aircraft time through Ivory Transportation, an entity funded entirely by Mr. Kivisto. The Report identifies no invoices from SemGroup for Mr. Kivisto's purported non-business use of a company plane. (Report at pp. 236-37); (2) all artwork purchased by SemGroup from any gallery affiliated with Mr. Kivisto was purchased either at cost or a discount to fair market price. (Report at pp. 244-245); (3) the Zaslunov paintings were purchased and owned by Kivisto Enterprises, not SemGroup. (Report at p. 245 fn.20); and (4) the Report refers to a reservation for an airport pick-up in Mexico, but does not disclose that the reservation was paid for by Mr. Kivisto and not SemGroup (Report at p. 237).
  - The Report fails to mention that Mr. Kivisto invested his own funds into SemGroup and SemGroup Energy Partners, LP in 2007 and 2008, and that he answered every capital call. In the summer of 2008, Mr. Kivisto obtained an oral commitment for a \$500 million investment in SemGroup from the Kuwaiti sovereign investment fund, approximately \$400 million from other investors, and Goldman Sachs' intense stated interest in putting SemGroup's equity on its GS TrUE private exchange; he had every reason to believe SemGroup would weather the storm. Mr. Kivisto did not sell one unit from either SemGroup or SGLP. In fact, he invested in SGLP units only four months before SemGroup filed for bankruptcy. Mr. Kivisto had total faith in SemGroup's employees, trading strategy and future, and he backed up this belief with of his own dollars.