
Oil and Gas Bankruptcy Considerations

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Traditionally, the industry is broken down into three sectors



Upstream:

Exploration &
Production

Midstream:

Pipeline
Transportation
Marine Transportation
Gas Gathering

Downstream:

Refineries
Storage Terminals
Refineries
Power Generation
Trading
Marketing

Support Activities for Upstream and Midstream Sectors:

Upstream:

Geophysical Services
Drilling Contractors
Equipment Providers
Production Services
Well Services

Midstream:

Pipeline Construction &
Services
Transportation Scheduling
Marine Vessel Construction

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Source: Energy Information Administration based on data from various published studies.
 Updated: May 9, 2011

U.S. Natural Gas Shale Basins Align with Pipeline Grid



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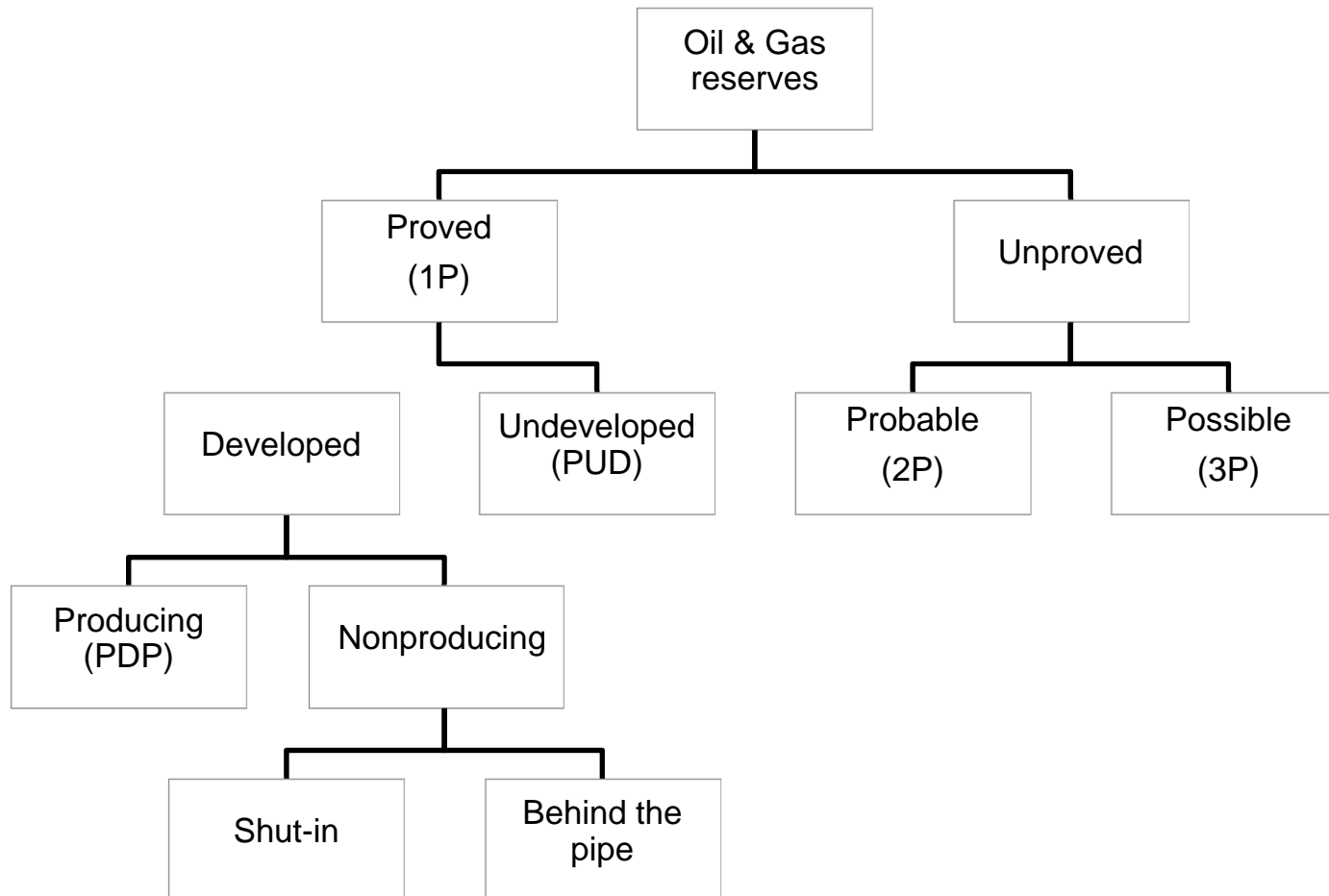
Oil & Gas as Commodities

- Commodity prices are volatile
- Depend on supply and demand (i.e., weather and manufacturing levels)
- A Borrower's profitability and liquidity can change quickly
- Oil is a global commodity because it is more easily transported (truck, pipeline, ship)
- Gas has historically been more regional. Will LNG (Liquified Natural Gas) change that?
- Distress in E&P sector affects midstream and downstream

Types of Reserves

- **Proved reserves:** Those reserves that on the available evidence are virtually certain to be technically and economically producible (i.e., have a better than 90 percent chance of being produced).
- **Proved field:** An oil or gas field whose physical extent and estimated reserves have been determined.
- **Probable reserves:** Unproved reserves that are estimated to have a better than 50 percent chance of being technically and economically producible.
- **Possible reserves:** Unproved reserves that at present cannot be regarded as “probable” due to a low probability of profitable development. The industry standard probability that these reserves are technically and economically producible is 10 percent (or moderately higher).
- **Recoverable reserves:** That proportion of the O&G in a reservoir that can be removed using currently available techniques.
- **Primary recovery:** Recovery of oil or gas from a reservoir purely by using the natural pressure in the reservoir to force the oil or gas out.

Relationship Among Oil and Gas Reserves



Common Oil and Gas Interests

- **Mineral interest:** A property interest that is created by an instrument that transfers, by a grant, assignment, reservation, or otherwise, an interest of any kind in coal, O&G, and other minerals.
- **Landowner or non-participating royalty interest:** A property interest in O&G minerals, whose owner is entitled to a share of production when there is production. A royalty interest is free of the costs of production.
- **Working interest:** A percentage of ownership in an O&G lease that grants its owner the right to explore and produce O&G from a tract of property (operating or non-operating).
- **Overriding royalty interest:** Non-operating/non-expense bearing working interest in the production of O&G rather than a property interest in the minerals in the ground.
- **Net revenue interest:** A property interest the assignee of a lease actually has in the profits of the mineral-production operations, free of production costs after all royalties and overriding royalties are paid out.

Contractual Arrangements

- **Ground Lease:** A lease agreement that allows a tenant to develop the property for the lease period but forfeits rights to the improvements to the property owner when the lease has matured.
- **Turnkey contract:** A drilling contract that calls for the completion of a well for a fixed price. All costs, including those that are unexpected, must be borne by the drilling contractor.
- **Joint Operating Agreement:** A contract that regulates the relationship between the operator and non-operator. Operator has responsibility of day-to-day operations. Non-operator has financial commitment (AAPL model form).
- **Held by Production:** The continuation of a lease based on production. If production ceases for a specified period of time, the lease terminates.

LOAN STRUCTURE

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Term Facility

- Used to finance acquisitions of interests
- Amortized over life of loan
- Administratively less complicated than reserve based revolving facilities

E&P Revolving Credit Facility

- Used for working capital or to develop existing Oil & Gas properties
- Maximum amount Bank will loan based on collateral values available under financing at any one time set by an initial borrowing base determination
- Basis of Borrowing Base
 - Oil & Gas Reserves based on Third Party Reserve Reports
 - Proven vs. Probable or Possible reserves
 - Includes Bank's reserve engineer's assumptions about valuation of reserves
 - Percentage of reserves set borrowing base

Borrowing Base

- Maximum amount of money a lender will loan to a company, based on collateral values.
- Bank determines a discount factor (i.e., a certain percentage which is multiplied against the value of the collateral). The resulting value is the maximum amount of money the Bank will loan to the company. For Oil & Gas typically 50% to 60% of proved producing reserves.
 - Example: If a company has proven reserves worth \$10,000,000, and the lender's discount factor is 50%, the borrowing base is \$5,000,000.
- Credit available is **lessor** of (i) \$ [stated amount of revolver] and (ii) borrowing base

Determining Collateral Value

(risk adjustment net present value)

- 100% of “seasoned” PDP (i.e., over 6 months of production)
- 90-95% unseasoned PDP
- 65-75% of PDNP
- 20-50% of PUD reserves (probably lower now)
- Total PNDP and PUD cannot exceed 25-35% of valuation
- Unproved (probable/possible) not included in reserve based lending

Setting the Borrowing Base

(based on risk adjusted values)

Example #1

- 50-65% of NPV of PDP
- 50% of NPV of PDNP
- 35% of NPV of PUD reserves

Example #2

- 50-65% of NPV of Proved Reserves
- PDNP and PUD no more than 25-35%

*No single well providing more than 15-20% of Borrowing Base

Borrowing Base Redetermination

- Borrowing Base redetermined over life of loan
 - Frequency of redetermination negotiated (OCC says at least semi-annually)
 - Event-driven or borrower initiated redetermination (motivations for determination can vary)
 - Unique perils for E&P companies during challenging periods (even relatively small declines in commodity prices could have significant impact on the borrowing base)
 - A large undrawn revolver may be meaningless in terms of liquidity

Examples of Borrowing Base Stretches

- Higher advance rates for PDNP and PUDs
- Lending beyond 100% of PDPs
- Lowering Discount Rate

Engineering Report Assumptions

The Bank's petroleum engineer (e.g. Ryder Scott) will value the collateral based on four key assumptions:

- Pricing
- Costs
- Discount Rate (PV-10 (stands for 10% discount rate) is the standard rate for SEC purposes for discounting revenues to present value)
- Timing

Exploration & Production

Drill or Die



Types of E&P Assets and Liabilities

Assets:

- Working Capital
- Oil and Gas Reserves
- Hydrocarbon Inventory
- Hedging Instruments
- Other Fixed Assets
 - Gathering systems, helicopters, landing pads, boats, etc.
- Seismic Data
- Permits and Licenses
- Contracts

Liabilities:

- Asset Retirement Obligations
- Environmental Liabilities
- Pre-emptive Rights
- Debt

***Transactions are typically structured as asset purchases.

Asset Retirement Obligations – Plugging and Abandonment

- An obligation of the operator; not necessarily limited to the existing operator
- The Government must be satisfied at all times (cash, bonding, exempt)
- Liabilities can go with assets in a foreclosure sale, bankruptcy §363 sale or reorganization

Special Priority Issues: Mechanics and Materialmen's Liens (a state by state analysis)

- Statutory Liens typically given to persons performing services or providing materials in the oil and gas industry

Example: Oilfield service company contract to drill well for leaseholder

- Liens cover “mineral activities” – “digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas or waterwell, an oil and gas pipeline, or a mine or quarry”
- Broad coverage in many states
- Lien may cover all wells on the lease not just the well for which materials and services provided
- Lien may cover all contiguous acreage operated as a single unit

Carrier and Warehouse Liens

- Storage Tanks
- Pipelines

Example: In *Lyondell* the debtor obtained authority to pay the pre-petition claims of its carriers and warehouseman in full as one of its “first day” motions.

Is My Claim Really Senior?

- ORRIs (overriding royalty interests) – Impact on Cash Flows and Collateral Position
 - But is it an ORRI or a financing? *ATP, Inc.* (S.D. Tex.)
Most ORRIs are not perfected as a loan would be so that if it is held to be a financing the ORRI owner would be an unsecured creditor.
- NPIs (net profit interests) – Impact on Cash Flows
- M&M Lien Claims – Impact on Collateral Position and Repayments
 - Lien typically relates back to when services began
- Asset Retirement Obligations / P&A liability claims – Impact on Repayments

Key Oil & Gas Bankruptcy Concepts

- Executory Contracts and Contract Rejection
- Automatic Stay
- Security and Priority of Payment
- Financial Contracts and Safe Harbors
- Bankruptcy Litigation

Types of Oil & Gas Executory Contracts

- Character of oil & gas leases determined by state law
 - Examples: - Texas – Not a lease it is a fee interest in real estate
 - Kansas – It can be rejected as a license to go on the land to search for oil
- Right of first refusal (courts not consistent)
 - Executory contract; or
 - Covenant running with the land
- Joint Operating Agreement (JOA)
 - Executory
 - Co-operators are different
- Farm out Agreement is executory but special Bankruptcy Code provision prevents farmer/debtor from depriving farmor of title (11 U.S.C. § 541(b)(4))

Types of Oil & Gas Executory Contracts (cont'd)

- Gas gathering and related agreements.
 - Recent decision in the *In re Sabine Oil & Gas* (S.D.N.Y.) case held that a Gas Gathering Agreement was not a covenant running with the land and could be rejected.
 - Significance of the Sabine ruling will depend on whether the producer/debtor has an alternative to market its production. If an alternative exists then the producer/debtor would have substantial leverage to negotiate new terms.
- Recoupment
 - In the *Energy & Exploration Partners, Inc.* (N.D. Tex.) case the court allowed the midstream services provider to recoup its costs against amounts owed to the debtor. Recoupment was allowed even if the contracts were later rejected. Recoupment could lessen the impact of a broad application of the decision in *Sabine Oil & Gas*.

Automatic Stay

- Most actions against a debtor are ***immediately*** and ***automatically stayed*** upon the filing of a bankruptcy petition.
- The automatic stay ***prevents a counterparty from suspending performance under a contract or terminating a contract*** (unless it is a forward contract).
- Creditors are also ***barred from creating or enforcing liens*** against property of the Bankruptcy estate without court permission with exception of timely filing of M&M liens under state law.

Bankruptcy 101

Assets fmv	500,000
Liabilities	2,000,000
Bank Debt	500,000
Trade Debt	750,000
Judgment	750,000

If Bank is secured and perfected - 100% recovery

If Bank unsecured or unperfected - 25% recovery

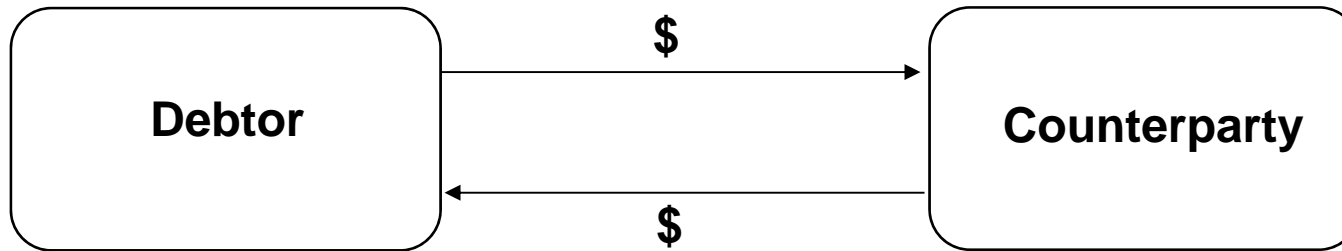
Royalty and Interest Owners

- Naked royalty v. owner of “interest” in the land. In many states royalties owed by the debtor are not considered property of the estate. In those states royalty owners would not be creditors.
- Must “sell” something to be secured
- Lien only attaches to proceeds that can be traced to hands of operator or first purchaser
- Perfected Lien of Lender under UCC can trump lien of producer

Common Statutory Possessory Liens

- FERC or State Lien - Common Carrier Pipelines
- UCC 7.307 Lien of Carrier- Pipeline
- UCC 7.209 Lien of Warehouse – Terminalling

Set Off



- Set off exists under common law and allowed in bankruptcy
- Debts owed by same parties in same capacity (both pre-petition/both post-petition)
- Affiliated companies which are legal entities are not “same party” **[and you cannot acquire a claim for purposes of set off]**

Set off and Netting in the Oil & Gas Industry

- Industry relies heavily on netting b/c not enough credit to support otherwise
- Vendors/Counterparties are becoming more savvy at assessing creditworthiness

SemCrude Issues: *Producers v. Banks*

- Delaware ruled for Banks over unpaid producers
- Disregarded Texas and Oklahoma liens favoring producers
- Would Texas or Oklahoma have ruled differently?

Forward Contracts

- [“F]orward contracts are negotiated between industry participants and forward contract merchants. The industry participants are either producers or users of the commodity who sell or purchase the commodity in advance to hedge against price fluctuations. Forward contract merchants create or manage commodity markets by providing a place for industry participants to buy or sell a commodity in advance of its actual production.

Special “Safe Harbor” Protection

- Financial contracts are protected from fraudulent transfer and preference attack (except in case of actual fraud) and the automatic stay does not prevent termination and netting
- A financial contract carries with it a right to liquidate, terminate, accelerate or offset under a master netting agreement and across contracts

Bankruptcy “Adversary Proceedings” (a/k/a Litigation): The Litigation Trust

- Preference Actions
 - Payments made within 90 days of the filing may be avoidable

- Fraudulent Conveyance Actions
 - Pre-bankruptcy transactions up to 6 years (depending on state law) may be scrutinized in a subsequent bankruptcy
 - Did the debtor pay too much for an acquisition? Or sell assets for too little?

- Commercial Tort and Contract Actions

DISTRESSED LOAN TRADING CONSIDERATIONS

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Distressed Trading Considerations

- Voting Rights
 - Trade Date or Settlement Date?
- Restructuring Support Agreement
 - Is there an RSA?
 - Locked or Unlocked Loans?
 - QM Exception?
- APO
 - Trade Flat or SWOA?
 - Back End Payments
- Shift Date
 - Typically Payment Default or Bankruptcy

Recent Material Bankruptcies

<u>Debtor</u>	<u>Credit Agreement</u>	<u>Aggregate Amount of Syndicated Debt as of Petition Date (USD)</u>	<u>Bankruptcy Case</u>	<u>Bankruptcy Court</u>	<u>LSTA Shift Date</u>	<u>Petition Date</u>	<u>Adequate Protection Order (APO)</u>	<u>Restructuring Support Agreement (RSA)</u>
Quicksilver Resources	First Lien Credit Agreement (US/CAD), dated December 22, 2011 (Revolver & L/C)	\$273mm	<i>In re: Quicksilver Resources Inc., et al.</i> , Case No. 15-10585 (LSS) (Jointly Administered)	Bankr. Dist. DE	2/19/2015	3/7/2015	Final APO, dated May 1, 2015.	No
	Second Lien Credit Agreement, dated June 21, 2013 (Loans)	\$625mm						
Sabine Oil & Gas	Second Lien Credit Agreement, dated December 14, 2012 (Loans)	\$650mm	<i>In re: Sabine Oil & Gas Corporation, et al.</i> , Case No. 15-11835 (SCC) (Jointly Administered)	Bankr. S.D.N.Y.	3/16/2015	7/15/2015	Final APO, dated September 16, 2015.	No
	Second Amended and Restated Credit Agreement, dated as of December 16, 2014 (Revolver)	\$750mm						
Samson Resources	First Lien Credit Agreement, dated as of December 21, 2011 (Revolver)	\$942mm	<i>In re: Samson Resources Corporation, et al.</i> , Case No. 15-11934 (CSS) (Jointly Administered)	Bankr. Dist. DE	3/12/2015	9/16/2015	Sixth Interim APO, dated March 21, 2016.	Yes, dated August 14, 2015
	Second Lien Credit Agreement, dated as of September 25, 2012 (Loans)	\$1bn						

Recent Material Bankruptcies

<u>Debtor</u>	<u>Credit Agreement</u>	<u>Aggregate Amount of Syndicated Debt as of Petition Date (USD)</u>	<u>Bankruptcy Case</u>	<u>Bankruptcy Court</u>	<u>LSTA Shift Date</u>	<u>Petition Date</u>	<u>Adequate Protection Order (APO)</u>	<u>Restructuring Support Agreement (RSA)</u>
Energy & Exploration Partners, Inc.	Credit Agreement, dated as of July 22, 2014 (Loans)	\$765.3mm	<i>In re: Energy & Exploration Partners, Inc., et al.</i> , Case No. 15-44931 (RFN) (Jointly Administered)	Bankr. N.D. Tex. (Fort Worth Div.)	12/17/2015	11/25/2015	Final APO, dated January 29, 2016.	Yes, dated February 9, 2016
Magnum Hunter Resources Corp.	Second Lien Credit Agreement, dated October 22, 2014 (Loans)	\$336.6mm	<i>In re: Magnum Hunter Resources Corporation, et al.</i> , Case No. 15-12533 (KG) (Jointly Administered)	Bankr. Dist. DE	12/4/2015	12/15/2015	Final APO, dated January 11, 2016.	Yes, dated December 15, 2015
Quicksilver Resources	First Lien Credit Agreement (US/CAD), dated December 22, 2011 (Revolver & L/C)	\$273mm	<i>In re: Quicksilver Resources Inc., et al.</i> , Case No. 15-10585 (LSS) (Jointly Administered)	Bankr. Dist. DE	2/19/2015	3/7/2015	Final APO, dated May 1, 2015.	No
Swift Energy Company	Second Amended and Restated Credit Agreement, dated as of September 21, 2010 (Revolver)	\$330mm	<i>In re: Swift Energy Company, et al.</i> , Case No. 15-12670 (MFW) (Jointly Administered)	Bankr. Dist. DE	N/A	12/31/2015	Final APO, dated February 2, 2016.	Yes, relevant only to senior notes, certain unsecured creditors, and DIP lenders.
Emerald Oil	Amended and Restated Credit Agreement, dated as of April 30, 2014	\$113mm	<i>In re: Emerald Oil, Inc., et al.</i> , Case No. 16-10704 (KG) (Jointly Administered)	Bankr. Dist. DE	N/A	3/22/2016	Final APO, dated May 6, 2016.	No

Recent Material Bankruptcies

<u>Debtor</u>	<u>Credit Agreement</u>	<u>Aggregate Amount of Syndicated Debt as of Petition Date (USD)</u>	<u>Bankruptcy Case</u>	<u>Bankruptcy Court</u>	<u>LSTA Shift Date</u>	<u>Petition Date</u>	<u>Adequate Protection Order (APO)</u>	<u>Restructuring Support Agreement (RSA)</u>
Energy XXI	Second Amended and Restated First Lien Credit Agreement, dated as of May 5, 2011 (Revolver)	\$327.1mm	<i>In re: Energy XXI Ltd, et al.</i> , Case No. 16-31928 (Jointly Administered)	Bankr. S.D. Tex. (Houston Div.)	N/A	4/14/2016	Interim APO, dated April 15, 2016.	Yes, dated April 11, 2016
Ultra Resources	Credit Agreement dated as of October 6, 2011 (Revolver)	\$1bn	<i>In re: Ultra Petroleum Corp., et al.</i> , Case No. 16-32202 (MI) (Jointly Administered)	Bankr. S.D. Tex.	4/30/2016	4/29/2016	N/A	No
Midstates Petroleum	Second Amended and Restated Credit Agreement, dated as of June 8, 2012 (Revolver)	\$249.2mm	<i>In re: Midstates Petroleum Company, Inc., et al.</i> , Case No. 16-32237 (Jointly Administered)	Bankr. S.D. Tex. (Houston Div.)	N/A	5/1/2016	Interim APO, dated May 2, 2016.	Plan Support Agreement, dated April 30, 2016
Linn Energy	Sixth Amended and Restated Credit Agreement dated as of April 24, 2013 (Revolver and Loan)	\$1.939bn	<i>In re: Linn Energy, LLC, et al.</i> , Case No. 16-60040 (Jointly Administered); Linn Energy, LLC (7591); Berry Petroleum Company, LLC (9387)	Bankr. S.D. Tex.	N/A	5/11/2016	Motion pending for Interim APO, filed 5/11/2016.	Yes, dated May 10, 2016
Berry Petroleum	Second Amended and Restated Credit Agreement, dated November 15, 2010 (Revolver)	\$900mm						