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BANKRUPTCY  
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# 2017 Central States Bankruptcy Workshop

## Energy Case Studies

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## Energy Case Studies Panel

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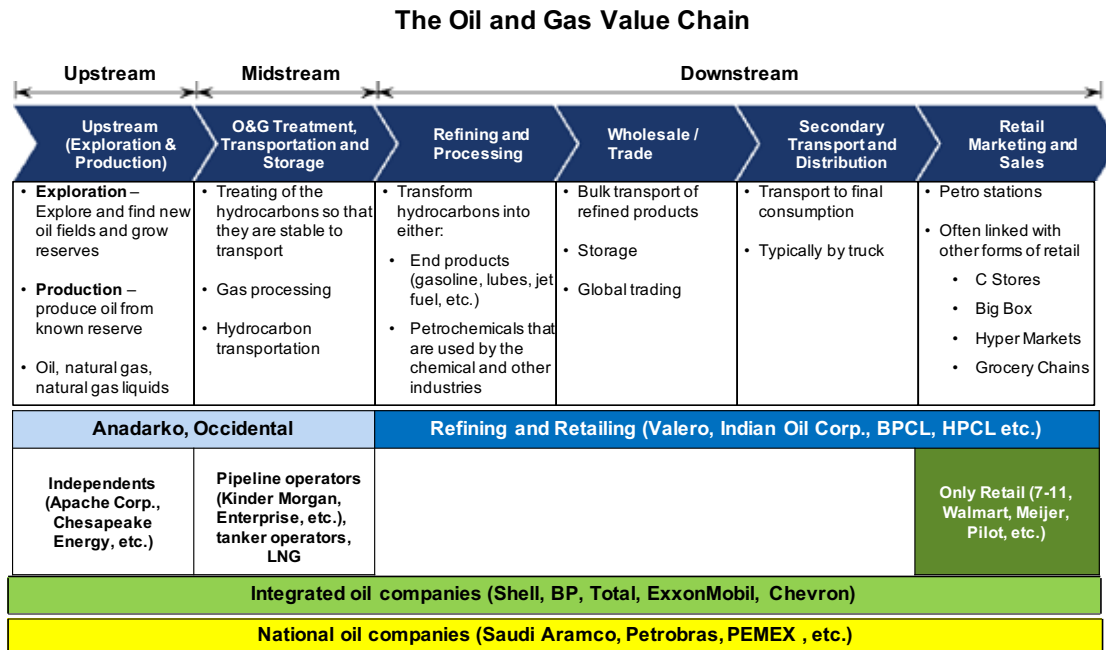
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## Oil and Gas Industry Overview

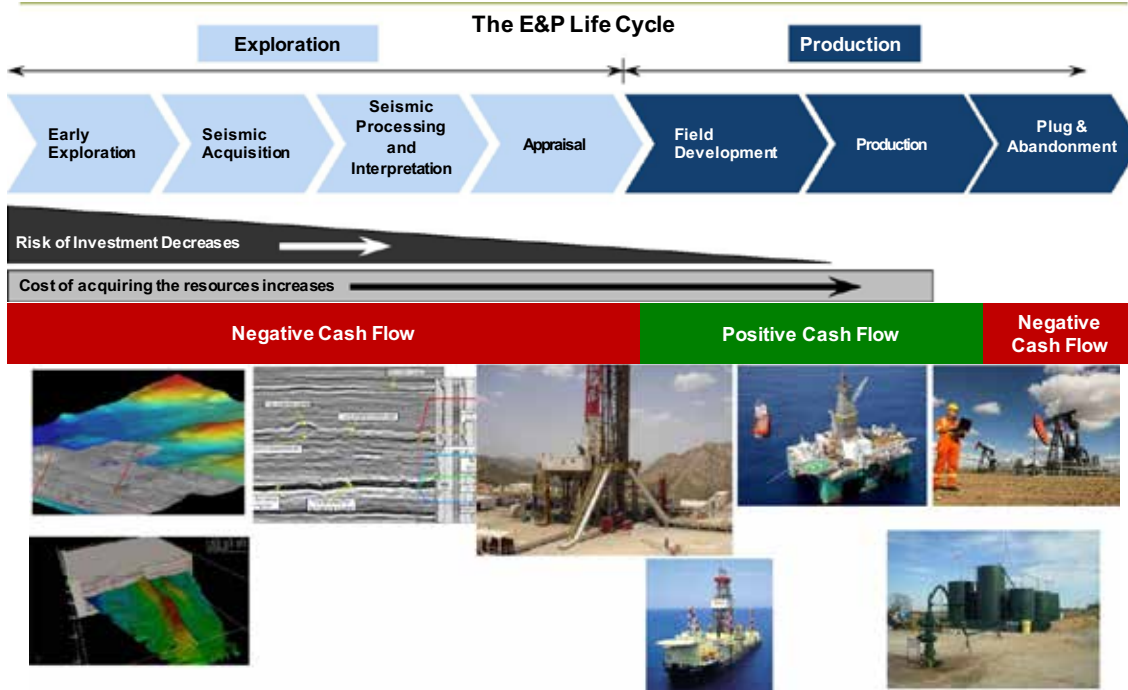
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The oil and gas value chain has three distinct sections: upstream, midstream & downstream



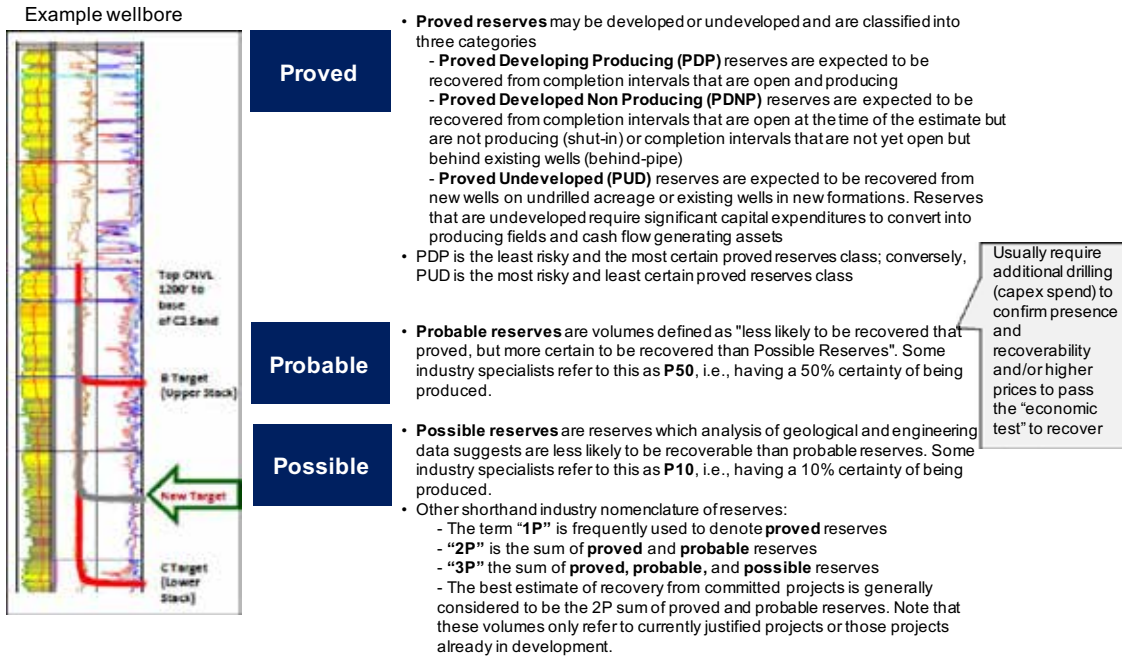
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Exploration & Production (E&P) consists of various activities



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## Key assets of an O&G company are reserves, economic quantities of oil and gas that can be recovered – 3 different classifications



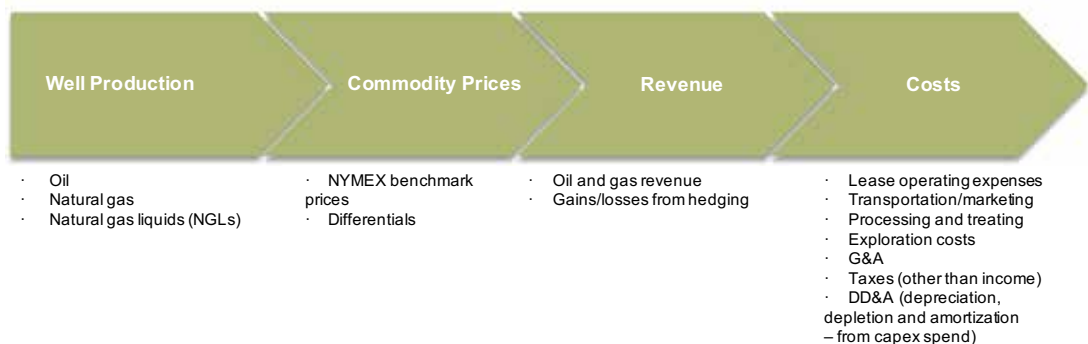
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## An Upstream E&P Cash Flow Framework

Upfront activities typically associated with investment required to generate positive cash flows



### Key cash flow components

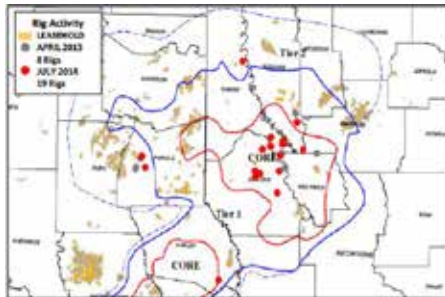


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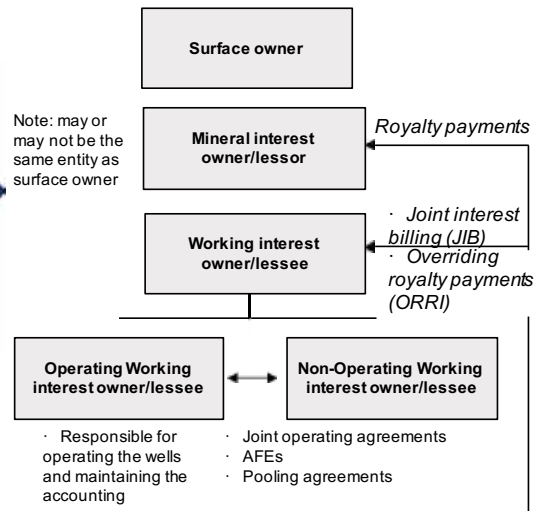
## The O&G industry is often a patchwork of ownership interest and partnerships that creates complexity for understanding cash flows

Geological and geophysical activities determine the best potential areas to drill...

...Which leads to petroleum landmen and brokers working to lease the mineral rights from property owners



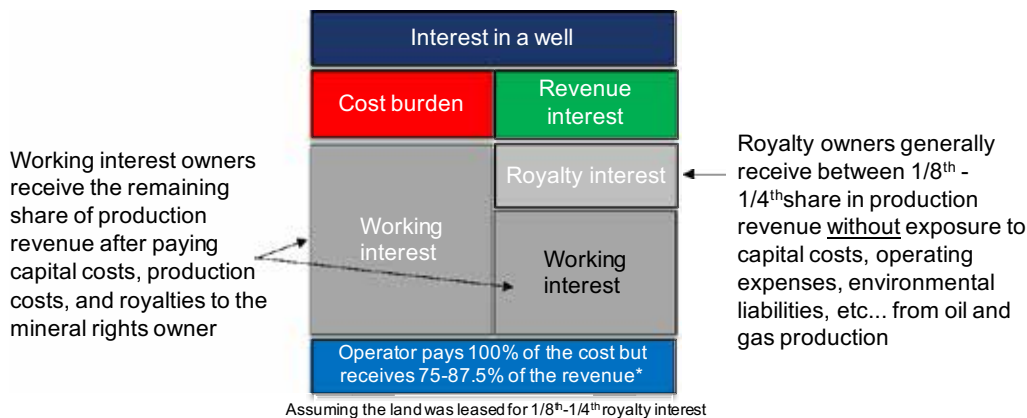
Note: may or may not be the same entity as surface owner



Note: ORRI can be created when a company promotes or "farms-in" a partner into a drilling prospect and earns a disproportionate share of the revenue interest in a well; it is not an interest in the minerals but rather a share of the proceeds of oil and gas minerals sold. This interest is carved out of the working interest of an owner rather than the mineral interest owner's share

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## "Interests" in wells vary leading to important considerations related to revenue and cost accounting

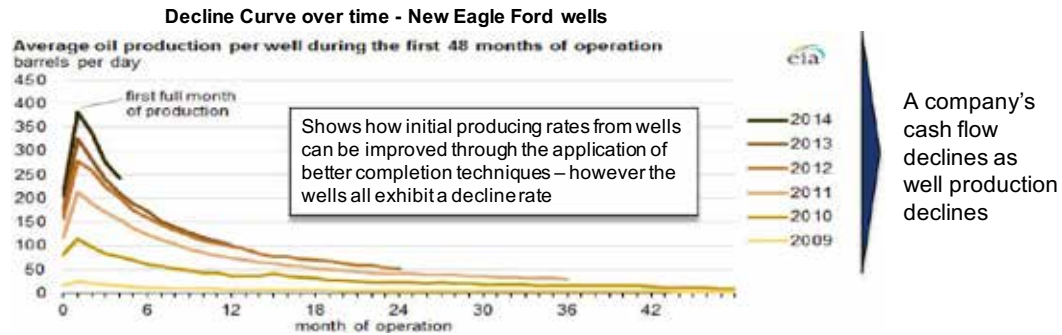


Lots of complications exist which can create accounting complexities. For example:

- The ownership of mineral rights can vary based on well depth. So even within the same wellbore, there can be different royalty rates applied to cash flows
- Oil companies often "promote" drilling opportunities to each other as a way of reducing their exposure/risk to any particular drilling opportunity. The result is that there often are several working interest owners in every well
- Land leasing is very competitive, so companies are leasing sections/parcels of land near to each other. When it comes time to drill a well, these parcels can be combined into a "unit" for drilling purposes – resulting in shared ownership
- Mature fields are often "unitized" to facilitate secondary or tertiary recovery techniques such as waterflooding or CO<sub>2</sub> flooding to ensure that an entire field is efficiently developed. This can result in many working interest owners in the same project

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## Once a well is “drilled” and “completed” and ready to produce, an important concept for cash flow modeling is well decline rates

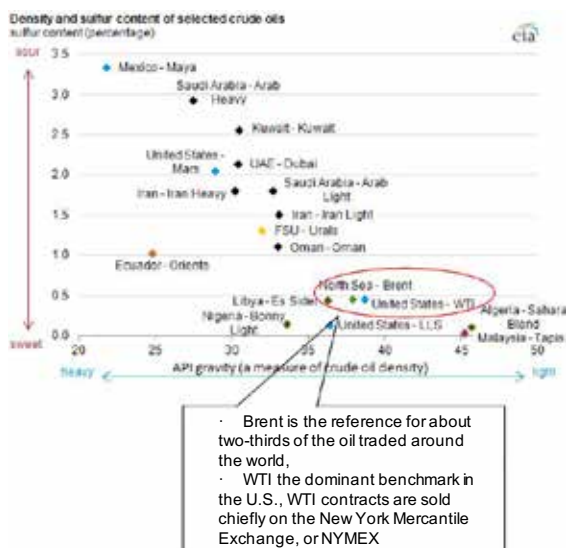


- All producing wells exhibit a decline rate after initially getting up to full production levels (the “IP” – initial production rate). The decline is caused by the decline in reservoir pressure as wells “deplete”
- The rate of decline varies widely across fields and even wells within the same field. There are wells that decline at 1-2% per year – and those that decline at 70-80% per year – and everything in between
- The decline rate can follow many patterns – exponential decline, hyperbolic decline, etc..
- Oil companies utilize different techniques to control and/or minimize the decline rates from their producing wells.
  - Applying a surface “choke” to reduce the flow rate but minimize the decline
  - Employing pressure management techniques like waterflooding to minimize pressure decline in a field
    - Utilizing subsurface pumps to continue producing wells with the field pressure is too low for natural pressure to push the oil and/or gas to the surface
  - Many other techniques...

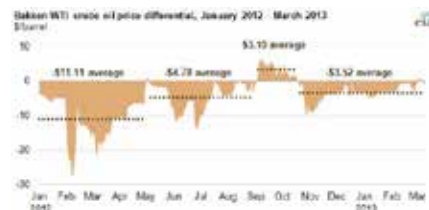
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## Not all crude oil is priced the same - most crude oil in the US is sold based on the NYMEX WTI benchmark price – with adjustments

### Crude Oil Characteristics Crude Oil Price

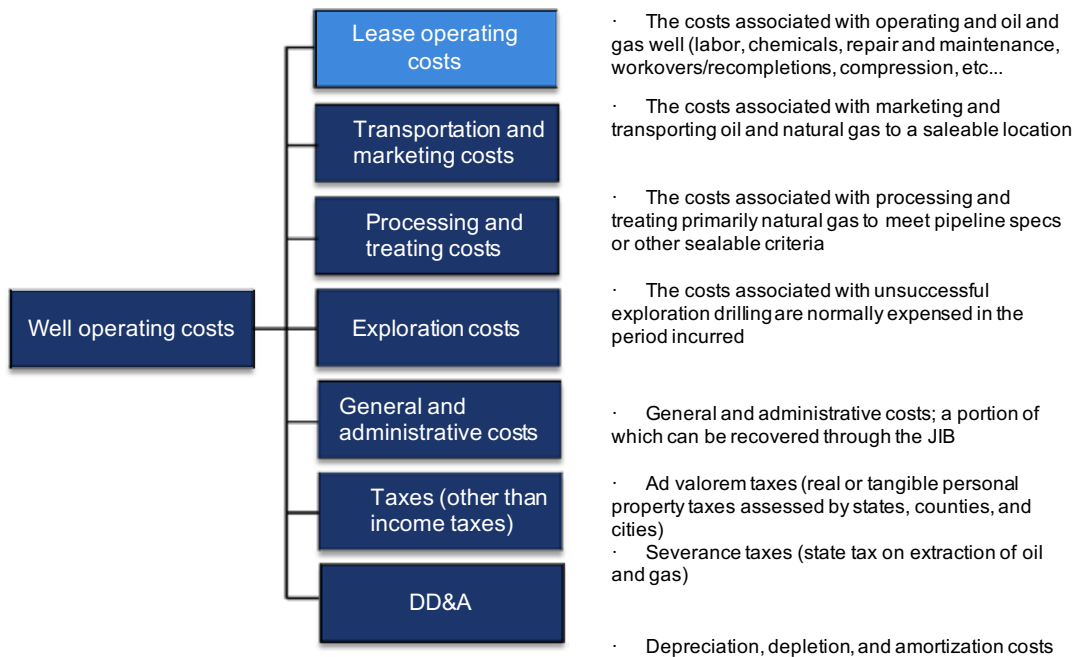


- The price of the produced oil is commonly known as the “wellhead price”
- The price an individual operator may get in any given field may be more or less than the NYMEX WTI Price. The price differential is based on a number of factors – quality, location, transportation, and storage
  - o Quality of the crude (as measured by its API gravity and/or level of contaminants (sulfur, water/sediment, etc...)). - California/Canadian crude are heavy sour crudes that sell at a significant discount to WTI
  - o Distance from settlement location and ease of transportation – constraints in transportation results in a discount



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## Oil producing costs are the key costs, typically called “LOE” – lease operating expenses



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## Joint interest billing agreements dictate the terms by which operators bill non-operating working interest owners for their share of costs

A joint operating agreement (JOA) between working interest owners, stipulates the detailed terms for sharing revenue and costs



Results in the formal monthly process by which oil and gas accountants settle revenue and costs between working interest owners

- Outlines the rights and responsibilities among parties, including what costs can be charged to other working interest owners by the operator of the well – as well as how revenue will be distributed (often governed by COPAS guidelines (Commission of Petroleum Accounting Societies))

- The operators' responsibility is to develop a monthly joint interest billing statement (JIB) that follows the terms of the JOA and enables the operator to recover a fair share of costs incurred with operating the oil and gas wells, including a share of G&A costs

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## Reserve-Based Lending Overview

> Reserve-based lending ("RBL") is a financing product that exists as a method for lenders to more effectively collateralize loans to fund E&P ventures that are deemed too risky for cash-flow based, or even traditional asset-based, facilities

- Independent E&P operators lack size and diversification, and often do not have access to hedging mechanisms that limit pricing risk
- RBL facilities provide a source of liquidity that is directly linked to the net present value of a company's portfolio of producing assets
  - Generally five-year tenor, with facility size and amortization schedule based on the company's production assets, production mix, capital expenditure plan, and cost structure
  - Reserves classified as "proved" are given consideration in the borrowing base calculation, with proved developed producing (PDP) and proved developed non-producing (PDNP) reserves receiving the highest percentage consideration (e.g., 100% for PDP and 75% for PDNP); proved undeveloped reserves (PUD) generally receive no more than 50% consideration and are capped as a percentage of the total borrowing base
  - Other variables considered by lenders include overall creditworthiness, equity sponsor support, operating history, and management team, among others
- During the most recent robust pricing environment, many E&P operators financed risky speculation centered on shale developments in part through funds provided by RBLs
- As such, the challenged pricing environment that began in 2014 has significantly impacted the ability of independent E&P operators to meet maintenance needs and fund working capital

> RBL facilities differ from traditional ABLs in several ways:

- Availability is calculated semi-annually instead of monthly
  - Immediately following Q1: Recalculated based on input and approval from third-party petroleum consultants as well as each lender's proprietary petroleum engineers
  - Immediately following Q3: Recalculated based only on input from each lender's proprietary petroleum engineers

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## Reserve-Based Lending Overview (cont'd)

- Each lender has an independent view of valuation that is generally based on a 15-20% discount to some measure of the forward price curve (e.g. WTI or Brent), referred to as a "price deck", as well as some discount to reserve amounts based on exploration risk, asset concentration, and reserve splits
- The determination of a new reserve base requires a quorum of between 67% and 100% of lenders by dollar commitment, depending on the terms of the agreement, the size of the company, and whether the proposed borrowing base is an increase or decrease relative to the prior period
- This redetermination ability provides lenders with the flexibility to positively or negatively adjust loan parameters to maintain adequate loan-to-value and cash flow coverage ratios that account for changes in a borrower's operations (e.g. asset acquisitions, production changes, commodity prices changes, etc.)

Variable Impacts that Reduce Borrowing Base	Variable Impacts that Increase Borrowing Base
Decrease in bank price deck assessment	Increase in bank price deck assessment
Decrease of any hedges at prices above the price deck	Increase in any hedge position with prices above the price deck
Slowing capital expenditure and drilling programs as decline rates increase in existing wells	Reclassification of reserves from proved and undeveloped to proved, developed, and producing
Increase in cost structure	Decrease in cost structure
Issues that negatively impact liquidity and operations	Operational improvements that positively impact productivity and yield
Negative revisions to reserve amounts	Positive revisions to reserve amounts

- The "cure" process to satisfy a reduced borrowing base level usually requires repayment to begin within 30 days of the redetermination, with payments spaced out over the course of a few months

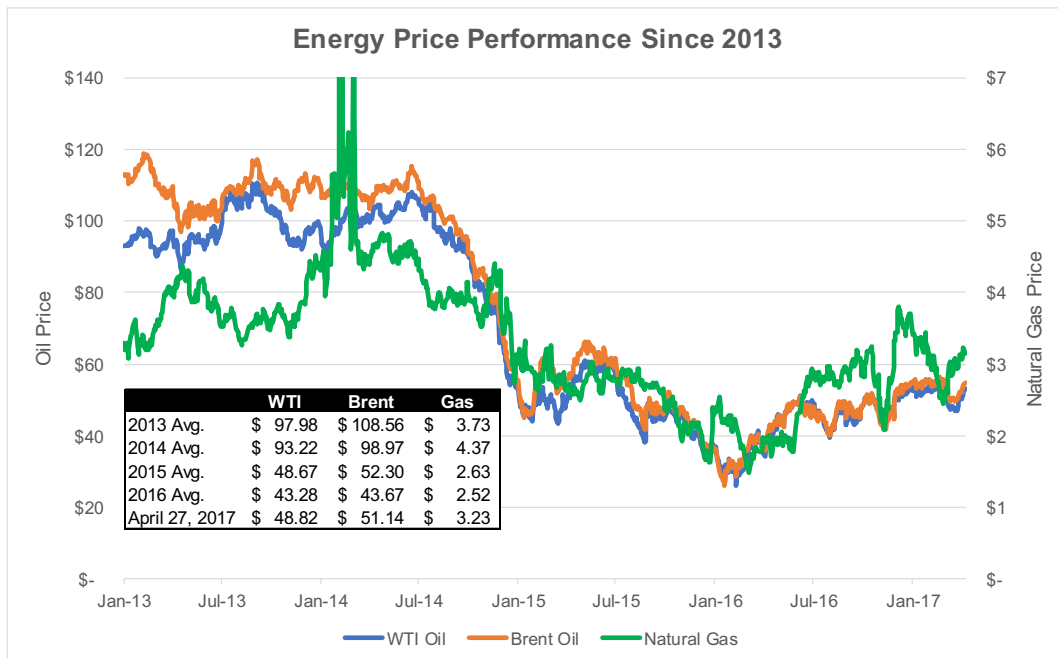
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# Oil and Gas Industry Restructuring Overview

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**Energy prices are substantially lower than the 2013 – 2014 timeframe, with some recovery since early 2016 (Jan 2013 – Apr 2017)**



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## The decline in energy prices led to a restructuring wave

Since June 30, 2015, there have been 130 energy-related bankruptcy filings. 35 of those companies had greater than \$250 million as of their filing date (as of April 2017):

Bankruptcy Filing	Debtor (Filing Company)	Bankruptcy Filing	Debtor (Filing Company)
03/18/2017	Ezra Holdings Limited (SGX:SDN)	05/11/2016	Linn Energy, Inc. (OTCPK:LNGG)
02/01/2017	Vanguard Natural Resources, LLC (OTCPK:VNRS.Q)	05/09/2016	Chaparral Energy Inc.
01/29/2017	Toisa Ltd.	04/13/2016	Peabody Energy Corporation (NYSE:BTU)
01/22/2017	Forbes Energy Services Ltd.	03/27/2016	Southcross Holdings LP
01/16/2017	Memorial Production Partners LP (NasdaqGS:MEMP)	03/23/2016	Abengoa Bioenergy Biomass of Kansas, LLC
01/04/2017	Bonanza Creek Energy Inc. (NYSE:BCEI)	03/22/2016	Emerald Oil, Inc.
12/14/2016	Stone Energy Corporation (NYSE:SGY)	03/18/2016	Venoco, Inc.
10/25/2016	Basic Energy Services, Inc. (NYSE:BAS)	02/14/2016	Paragon Offshore plc (OTCPK:PGNP.Q)
10/24/2016	Key Energy Services, Inc. (NYSE:KEG)	01/11/2016	Arch Coal, Inc. (NYSE:ARCH)
08/03/2016	Global Geophysical Services, LLC	12/31/2015	Swift Energy Company (OTCPK:SWTF)
07/27/2016	Halcón Resources Corporation (NYSE:HK)	12/17/2015	New Gulf Resources, LLC
07/27/2016	Titan Energy, LLC (OTCPK:TEN)	12/15/2015	Blue Ridge Mountain Resources, Inc. (OTCPK:BRMR)
06/29/2016	Triangle USA Petroleum Corporation	12/03/2015	Vantage Drilling International (OTCPK:VTGG.F)
06/02/2016	Warren Resources, Inc.	09/16/2015	Samson Resources Corporation
05/29/2016	Linc USA GP	08/03/2015	Alpha Natural Resources, Inc.
05/16/2016	SandRidge Energy, Inc. (NYSE:SD)	07/15/2015	Sabine Oil & Gas Corporation
05/15/2016	Breitbart Energy Partners LP (OTCPK:BBEP.Q)	07/15/2015	Milagro Oil & Gas Inc.
05/12/2016	Penn Virginia Corporation (NasdaqGS:PVAC)		

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## Types of Companies Affected



Land-Based E&P



Offshore drilling



Midstream



Hydraulic Fracturing (Fracing) and services



Geophysical



Offshore Supply/Support

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### Boom & Bust

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- History has a way of repeating itself, in the mid-1980's a surge of domestic oil production (akin to today's fracing) caused a 66% oil price decline in just over four months, beginning in November 1985.
- Prices took five years to recover from the excess supply created from surging U.S. production.
- During the ensuing five years, 54% of U.S. producers were either acquired or went out of business entirely.
- However, unlike the 1980's fracing requires continual investment, this means that once drilling becomes uneconomic due to low energy prices, supply will quickly decline. As such, there appears to be a more defined bottom to today's market.

-“Crude Collapse Has Investors Braced for '80s-Like Oil Casualties,” Bloomberg dated January 20, 2015

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### Chapter 11 Considerations

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#### > ORRIs (overriding royalty interests) and NPIs (net profits interests)

- ORRI owners receive a share of the production without any of the costs of production
- NPI owners receive a share of the profits from the operating property but are not responsible for the costs and typically do not have any rights with respect to operations
- ORRIs and NPIs generally characterized as an interest in real property for which the Bankruptcy Code specifically excludes them from the estate

#### > Mineral Interests Owners' Rights

- Treated as an unsecured claim, however, may challenge based on special language in the lease or state statute
- Mineral Interest owners may have the right to terminate due to non-payment of royalties
  - Debtors often seek to pay prepetition royalties to prevent termination as loss of the lease may significantly harm the estate

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## Chapter 11 Considerations

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### > JOAs (joint operating agreements)

- Multiple co-owners cooperating in the exploration, development and production under the management of a single operator
- JOAs are subject to rejection under the Section 365 of the Bankruptcy code
  - Can only be rejected by the debtor not against the debtor by non-debtors
- When operator is in bankruptcy, JOAs will often form an interim committee to control operations until the debtor elects to either accept or reject
- A non operator debtor may reject the JOA for which the non debtor counterparty would receive an unsecured claim for damages and breach of contract

### > Ad Valorem Taxes

- Real Property taxes, depending on the state, are generally secured by statute and receive the highest priority
- Severance taxes, depending on the state, are generally classified as Ad Valorem or property taxes and also receive secured status by statute
- Personal property taxes generally receive priority status

## Chapter 11 Considerations

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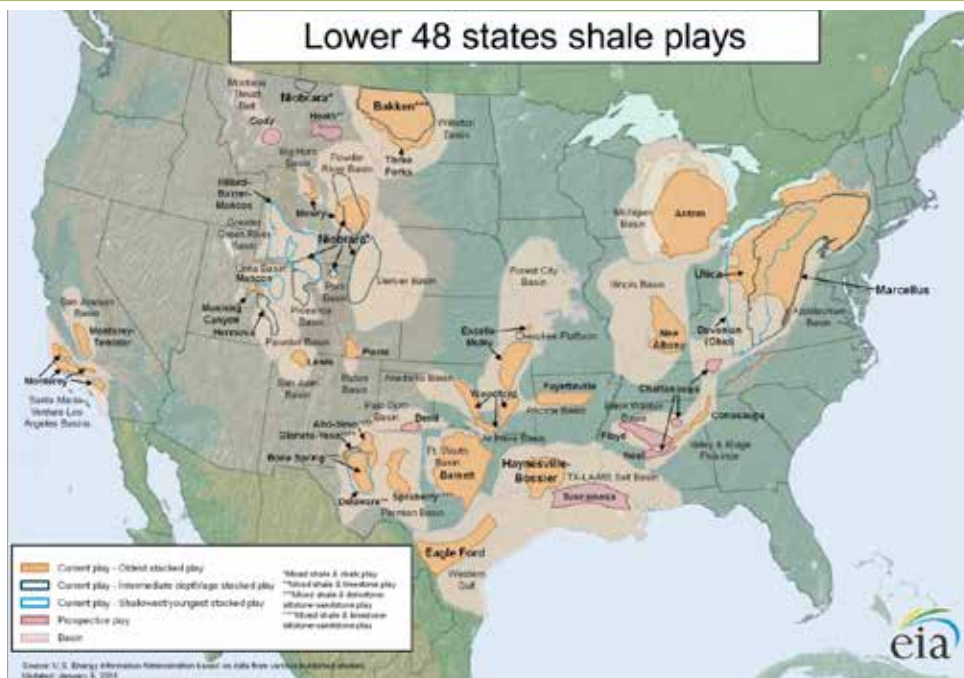
### > Oil and Gas Contractors' Liens (M&M Liens)

- Secured claim for labor and services
- Complex and subject to state law in determining priority versus a senior creditor's blanket lien, and extent of security interest

### > Plugging and Abandonment Liability

- Oil and Gas companies generally have a large liability on their balance sheet titled ARO or Asset Retirement liability
- The ARO reserve is the present value of the estimated remediation cost to restore the property at the end of its useful life (i.e. the cost to plug and abandon)
- Under federal law, offshore operators are required to plug and remove all structures within one year of the end of production
- A surety bond or escrow may be required to ensure that funds are available to meet this liability
  - Often important to file a surety bond motion as a first or second day motion in E&P cases
- Liability is only relevant in Chapter 11 if the company abandons wells. Even in a liquidation, if the production properties are sold as continuing operations, the liability is not relevant as part of the Chapter 11
- If the properties are abandoned and an adequate surety bond or escrow is not in place, such liability may receive administrative status due to public health and safety issues

## U.S. Shale Basins



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## Not All Basins Are Created Equal

"Everything Keeps Getting Bigger in Texas: No Slowing Permian Basin Growth Spurt"

-Oil & Gas 360 dated April 26, 2017

"It will take an almighty price war to really shut down the sweet spots of the (U.S.) Permian because the well production is so good and the breakevens are so low," Latham said

-"Fast-rising U.S. shale oil output puts OPEC cut at risk: Rystad," Reuters dated April 27, 2017

"It's simple economics. ... You are spending the least amount of capital [along the Permian], but here you get the most reserves on the ground," Kelly said on "Power Lunch." "Lower cost wins."

-"Now is the time to invest along the Permian Basin in Texas, oil analyst says" CNBC dated March 31, 2017

"Outside these two shale basins [Permian and Eagle Ford], drilling activity has remained muted. That is especially true in the international markets, where most oil and gas producers are still in capital-preservation mode."

-"If Rigs Counts Are Rising, Why Did These Rig Stocks Decline in March?," The Motley Fool dated April 3, 2017

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## Energy Case Studies: In re Sabine Oil and Gas Corp. [Bankr. S.D.N.Y. 15-11835]

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### Three Primary Industry Sectors

- **Upstream**
  - ♦ Consists of exploration, development and production (“E&P”) operators who find the gas and get it out of the ground.
- **Midstream**
  - ♦ Consists of transportation, storage and distribution operations.
- **Downstream**
  - ♦ Consists of refining, processing and marketing operations (i.e. Marathon, Phillips 66).



UPSTREAM



MIDSTREAM



DOWNSTREAM

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## Gathering Agreements Generally

- Under a gathering agreement, an E&P producer commits to deliver gas from specified wells, leases, or areas at agreed delivery points to the midstream gatherer, who agrees to gather, process and transport the gas to the downstream parties.
- A substantial capital commitment is necessary to build the pipeline system.
  - ◆ Thus, the producer usually commits to ship a minimum quantity over agreed time periods in order to assure the midstream gatherer of sufficient cash flow to amortize the construction costs of the pipelines.
  - ◆ If there is a short fall in such minimum quantity, the seller pays the deficiency.
- The language describing this commitment is sometimes called a “dedication.”

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## Gathering Agreements Generally

- Under Texas state law, gathering agreements have generally been understood to be binding on successors of the E&P producer.
- To effectuate this understanding, gathering agreements contain provisions:
  - ◆ Indicating that the obligations therein constitute “covenants running with the land” that are binding on successors.
  - ◆ Authorizing the midstream gatherer to record its interest in the real property records of the relevant county.
- The midstream gatherer customarily records the agreement in the county real property records in order to place all parties on notice.
- Additionally, an easement on the land is given to the midstream gatherer so that it can build and operate the pipeline.

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## Executory Contract or Covenant Running With Land?

- Under section 365(a) of the Bankruptcy Code, a debtor in possession, “subject to the court’s approval, may assume or reject any executory contract of the debtor.”
- That provision allows a debtor to reject executory contracts with another party if it is in the interest of the debtor’s business, notwithstanding any adverse effects on the non-debtor contracting party.
  - ♦ The bankruptcy court generally defers to a debtor’s determination as to whether rejection of an executory contract is advantageous, unless the decision to reject is the product of bad faith, whim or caprice.
- However, it is not possible for a debtor to reject a covenant that “runs with the land,” since such a covenant creates a property interest that is not extinguished through bankruptcy.

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## Executory Contract or Covenant Running With Land?

- In legal terms, a “covenant running with the land” is said to be an interest in real property that passes automatically when title to the land passes to a third party.
- In Texas, there are several requirements for a “covenant running with the land”:
  - ♦ The covenant must “touch and concern the land,”
  - ♦ The covenant must relate to something in existence or must specifically bind the parties and their assigns,
  - ♦ The covenant must be intended by the original parties to run with the land, and
  - ♦ Successors to the property burdened by the covenant must have notice of the covenant.
- Many courts have also required that the parties have “horizontal privity” of estate, meaning that the parties must have granted some interest in the real property at issue.

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## In re Sabine Oil and Gas Corporation

- Sabine Oil & Gas Corp., an E&P company, commenced its chapter 11 bankruptcy case on July 15, 2015 in the Southern District of New York.
- Sabine filed a motion to reject gathering agreements with two midstream counterparties.
  - ♦ The agreements obligated Sabine to deliver certain minimum amounts of gas and condensate to the midstream counterparties for the services provided thereunder and, to the extent that the debtor failed to deliver such minimum amounts each year, make deficiency payments on an annual basis.
  - ♦ The counterparties agreed to build, at their sole expense, a system of pipelines, treatment and disposal facilities.
  - ♦ Each agreement specifically provided that it was a “covenant running with the land” and was enforceable against Sabine, its affiliates and their successors and assigns.
- Sabine stated that it would “likely be unable” to deliver the minimum amounts of gas and condensate required under the agreements and, absent rejection, would be obligated to make about \$35 million in deficiency payments over the course of the gathering agreements.

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## In re Sabine Oil and Gas Corporation

- On March 8, 2016, Judge Chapman approved the debtor’s rejection of two gathering agreements with midstream services companies.
  - ♦ Given the burdensome nature of the gathering agreements, the court agreed with the debtors’ decision to reject each of the contracts.
- Nevertheless, for procedural reasons, the court could not make a final ruling on the issue of whether the gathering agreements “run with the land.”
  - ♦ The court could not decide factual issues in the 365 context, an adversary proceeding was necessary.
- In order to promote efficiency, however, Judge Chapman gave a thorough, non-binding indicative ruling applying Texas law, wherein she concluded that the covenants in the gathering agreements do not “run with the land.”

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## In re Sabine Oil and Gas Corporation

- This ruling left the debtor in a difficult position regarding future production.
  - ◆ The gathering agreements were rejected, but there was still some uncertainty regarding whether the covenants contained in the agreements continued or were terminated along with the rejection.
  - ◆ Thus, it was nearly impossible to negotiate and enter into new midstream contracts with a new midstream gatherer.
- Accordingly, the debtors commenced an adversary proceeding and sought a declaratory judgment on the issue of whether the covenants ran with the land.

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## In re Sabine Oil and Gas Corporation

- In a second opinion, dated May 3, 2016, the court held that the gathering agreements were not “covenants running with the land” under Texas law.
  - ◆ The agreements did not create “horizontal privity” between Sabine and the midstream parties because there was no conveyance of the real property or mineral interests.
    - Sabine simply engaged the midstream gatherers to perform services.
    - Moreover, none of the pipelines directly connected to the wells themselves.
  - ◆ The agreements did not “touch and concern” the land.
    - The covenants did not affect any interest in the real property, or its use, by the owner.
    - Unlike minerals in the ground (which are treated as real property), minerals extracted from the ground are personal property. Thus, the agreements only affected personal property rights.
  - ◆ The debtors’ lenders had not consented to a transfer of an interest in their collateral.
  - ◆ Moreover, Sabine had been using trucks instead of the midstream providers to move product, which evidenced that the covenants were not inextricably tied to the land.

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## In re Sabine Oil and Gas Corporation

- The midstream gatherers sought a stay of the decision and certification to appeal directly to the Second Circuit Court of Appeals.
  - ♦ They argued that these were unsettled issues of state law with the potential for significant consequences in the oil and gas industry.
- Judge Chapman disagreed, finding that her rulings were limited to the facts of the particular case and were based on well-settled bankruptcy law.
  - ♦ The alleged “far-reaching impact” of her opinions was “entirely speculative.”
- She also declined to stay her opinion.
  - ♦ There was no risk of irreparable harm to the midstream parties, as money damages provided an adequate remedy.
  - ♦ The debtor would be harmed by a stay because deficiency payments would continue to accrue.
  - ♦ She acknowledged that there was a chance of success on appeal, but not enough to justify a stay.
  - ♦ Public interest weighed in favor of expedient administration of bankruptcy proceedings.
- The midstream providers therefore appealed Judge Chapman’s final ruling to the District Court.

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## In re Sabine Oil and Gas Corporation

- On March 10, 2017, the District Court affirmed Judge Chapman’s rulings.
- The Court noted that the midstream providers had not shown that the agreements either increased their legal relations to the real property or decreased Sabine’s.
  - ♦ Sabine could produce as much or as little as it desired.
- It also rejected the midstream parties’ argument that the dedication of oil and gas “produced and saved” conveyed an interest in minerals in the ground, which under Texas law is a real property interest.
  - ♦ The midstream providers were not entitled to receive a share of the minerals before or after they came out of the ground.
  - ♦ Rather, they were entitled to process those minerals in exchange for a fee.
- Sabine’s obligations under the agreements were triggered only once the gas and condensate are produced, “at which point these substances are personal, rather than real, property.”
- The midstream parties have filed appeals with the Second Circuit Court of Appeals.

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## Implications of Sabine Oil and Gas

- The *Sabine Oil & Gas* opinions have given debtors greater leverage in negotiating with midstream gatherers to propose more beneficial gathering agreement terms.
  - ♦ In *Quicksilver Resources* [Case No. 15-10585, Bankr. D. Del. 2015], the proposed purchaser of the debtor's E&P operations required the rejection of the debtor's midstream services agreement. The sale was delayed while the issue was litigated. The parties reached an agreement shortly after the first *Sabine* opinion was issued.
  - ♦ In *Magnum Hunter Resources* [Case No. 15-12533, Bankr. D. Del. 2015], two of the debtor's midstream services providers challenged the rejection of their contracts. Again, the parties settled, with the debtor assuming the contract.
- The *Sabine Oil & Gas* opinions were based on an analysis of the specific contracts at issue (which dealt with oil being delivered, not oil still in the ground).
  - ♦ State laws vary greatly, and state and other bankruptcy courts may have different interpretations.

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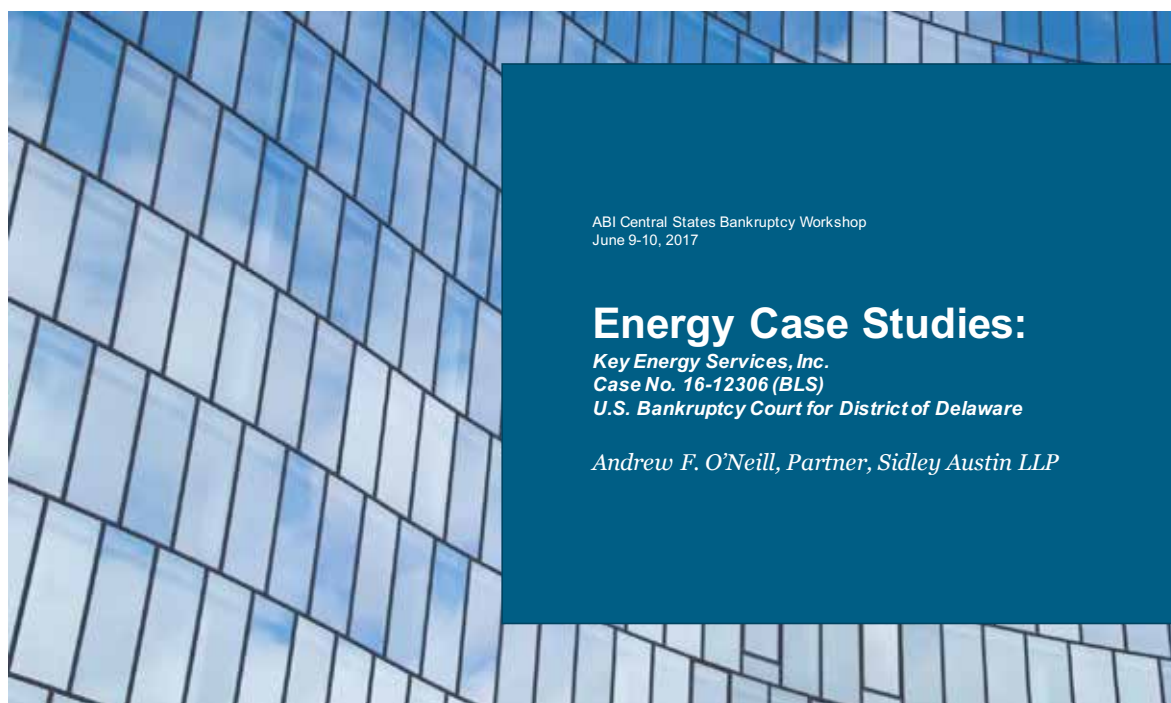
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WASHINGTON, D.C.

## Implications of Sabine Oil and Gas

- The ability to reject a gathering agreement is great leverage but, at the end of the day, the E&P company still needs someone to build and operate a pipeline.
- Moreover, to the extent that an E&P company successfully rejects a midstream contract, it may find itself in a dangerous position vis-à-vis its ability to continue to hold its oil and gas leases.
  - ♦ Most leases provide that, once production is obtained, it must continue without interruption subject to certain limited exceptions.
  - ♦ Thus, even a temporary delay creates a risk that the producer will be deemed to have forfeited its oil and gas leases.
- Given the foregoing, it is likely that the counterparties to gathering agreements will be incentivized to work together and negotiate a resolution.
  - ♦ Leverage will depend on how quickly the debtor can obtain a new midstream services provider at a competitive rate, and the producer's ability to survive a temporary shut down.

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**SIDLEY**

## OFS Industry Unrest and Distress

- Beginning in 2015, oil field services (“OFS”) companies (companies that drill wells, haul water, ship materials and provide other services to E&Ps) begin to experience distress resulting from the downturn in commodity prices.
- As E&Ps cut production, CAPEX spending decreases with consequent effects on OFS revenues and performance.
- Companies lay off workers and look to extend runway through amend/extend and recapitalization efforts.
- 127 OFS filings during 2015-April 2017, representing over \$25.8B in secured/unsecured debt.<sup>1</sup>
  1. 39 filings in 2015; Debtors with over \$5.3B in cumulative secured/unsecured debt.
  2. 71 filings in 2016; Debtors with approximately \$13.5B in cumulative secured/unsecured debt.
  3. 15 filings through April 2017; Debtors with over \$7B in cumulative secured/unsecured debt.

<sup>1</sup> Data from Haynes and Boone Oilfield Services Bankruptcy Tracker, April 27, 2017.

## Key Energy Services: Background

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- Key Energy Services, Inc. was organized in 1977, has approximately 3,000 employees and maintains principal executive offices/HQ in Houston.
- Largest onshore, rig-based well servicing contractor based on number of rigs owned.
- Provides full range of well services to major oil companies as well as independent oil and gas production companies.
- Services include well maintenance and workover services, well completion and recompletion, fluid management services, fishing and rental and other ancillary oilfield services.
- Company operated in 13 states and in Canada, Mexico and Russia.

## Key Energy: Prepetition Capital Structure

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- Key a public company with shares traded on the NYSE (KEG – delisted on September 6, 2016).
- Approximately \$1B in debt, consisting of:
  - Approximately \$290 million term loan;
  - Approximately \$38.5 million in outstanding LCs under revolving loan;
  - Approximately \$675 million of unsecured notes; and
  - Approximately \$20 million in trade claims.
- Liens on substantially all assets of the company and subsidiary obligors (Key Energy Services, LLC and Key Energy Mexico, LLC) to secure term and ABL facilities including.
- Total assets of \$1.13B at end of Q2 2016.

## Key Energy: Decline and Fall

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- Demand for Key's services fluctuates primarily in relation to the price or anticipated price of oil and natural gas. With dramatic drop in commodity prices beginning in mid-2014, demand for such services dropped.
- Given the decrease in demand for OFS services, competitors began aggressively pricing their services, putting further pressure on revenues.
- Key also involved in FCPA investigation regarding businesses in Mexico and Russia that ultimately resulted in a \$5 million settlement with SEC.
- Key significantly reduced headcount (>60% decrease) and sold assets to reduce costs/raise cash, but by early 2016, the need for a restructuring became inevitable and the Debtors approached the noteholders about organizing an ad hoc committee.
- Disputes with term lenders about appraisals and alleged defaults and litigation regarding same.
- By Summer, 2016 entered into serious discussions regarding chapter 11 options and equity splits, and obtained series of forbearance agreements with term lenders (and ABL lenders) through principal paydown.

## Key Energy: RSA and Plan Structure

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- Parties enter into RSA on August 24, 2016.
- RSA included comprehensive term sheets for prepackaged plan, rights offering, backstop agreement, exit term loan, corporate governance, warrant package and cash collateral usage.
- Key Plan terms:
  - Pay down term loan \$40 million in cash and amend/extend existing credit agreement (\$250 million exit term loan upon emergence)
  - Take out or replace ABL with similar facility
  - Notes to receive all of new equity, subject to dilution from rights offering shares, gift to equity and MIP
  - General Unsecured Claims to be paid in full in cash in ordinary course (certain claims capped under 502(b))
  - Equity to receive gift of 5% of new equity and warrant package for approximately 10% of new equity
  - Fully backstopped \$110 million rights offering (\$25 million through an "incremental" rights offering only triggered if cash fell below a certain threshold – essentially \$80 million)

## Key Energy: Case Timeline

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- RSA predicated on swift timeline to minimize costs and drag on the business during chapter 11 process.
- Various milestones in RSA requiring plan filing and solicitation deadlines, as well as back-end deadlines for confirmation and Plan effectiveness:
  - Commence solicitation by October 4, 2016
  - File cases by November 8, 2016
  - Have confirmation/disclosure hearing scheduled for no later than 60 days after petition date
  - Go effective no later than 90 days after the petition date
- Solicitation commenced on September 21, petitions filed on October 24, combined disclosure and confirmation hearing occurred on December 6 and the plan went effective on December 15.

## Key Energy: Confirmation

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- Potential plan issues: absolute priority and unequal treatment
- No major plan objections, and everything settled in advance of hearing
- Minimum cash threshold met and \$24 million of incremental facility funded through rights offering and backstop commitment
- Minimal exercise of cash-out option by equity holders
- New \$80 million ABL negotiated with prepetition ABL Lenders



## Key Energy: Post-Case and Next Steps

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- Pursuant to the Plan, the senior management team stayed place, but Board was replaced by majority shareholder Platinum Equity and ad hoc bondholders.
- Minimal ongoing bankruptcy issues (claims, etc...) because of fluid claims process and lack of bar dates. Case likely to be closed this Summer.
- Plan equity at emergence valued at \$12.00 a share, traded as high as \$37.55 in January and now trading in the mid-\$20s after commodity hiccup. Certain trading restrictions set to run off in mid-May, 2017.
- No major deals yet among peer OFS companies, despite predictions of consolidation in the industry.

## Other OFS Prepackaged/Pre-Arranged Bankruptcy Case Examples

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- Basic Energy (Prepack)
  - 45 days from petition to confirmation
  - \$775 in unsecured notes convert into 99.5% of new equity and rights to participate in rights offering
  - GUCs left unimpaired and old equity received 0.5% of new equity
- C&J Energy Services (Prearranged)
  - 21 weeks from petition to confirmation
  - \$1.4B in secured loans received all of new [common stock] and rights to participate in rights offering
  - GUCs received approx. 57% recovery in cash and warrants for up to 4% of new equity and old equity received warrants for up to 2% of new equity
- Seventy Seven Energy (Prepack)
  - 37 days from petition to confirmation
  - \$650 in Opco unsecured notes converted to 96.75% of new common stock and litigation proceeds
  - \$450 in holdco notes received [remaining] new common stock, warrant package for up to 15% of new common stock, and proceeds from litigation trust
  - Trade creditors unimpaired and old equity received warrant package for up to 20% of new holdco common stock.

## Next Chapter for OFS

- Companies continue to file to make sure they are in position to capture any upswing from Trump agenda or OPEC cuts.
- Consolidation predicted in the on-shore sector, especially among companies that have de-leveraged balance sheets and/or optimized business operations via restructuring.
- Biggest services providers, such as Halliburton and Schlumberger, continue to ride out the production declines, but remain well-positioned to respond to increased demand.
- Demand appears to be ramping up as major producers (e.g., Chevron, ConocoPhillips) prepare to add rigs and many other smaller E&Ps have reduced debt/optimized operations through restructuring processes.
- Decreasing amount of filings, now mostly off-shore and smaller privates.

## Black Elk Energy Offshore Operations, LLC

- Formed in November of 2007, Black Elk was a Houston-based oil and natural gas company engaged in the exploration, development, production and exploitation of oil and natural gas properties within the Outer Continental Shelf of the United States in the Gulf of Mexico.
- At one time the Debtor held an aggregate interest in more than six hundred seventy-five (675) wells on one hundred seventy-six (176) platforms located across two hundred fifty thousand (250,000) gross acres offshore in the Gulf of Mexico.

## Debt/Equity Structure

- Black Elk was owned by Platinum Partners (a New York based investment management firm with over \$1 billion in AUM).
- \$110 million Senior Credit Facility
- \$250 million Senior Notes
- Substantial P&A Bonding

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## August 2012 Rig Explosion

On August 12, 2012, an explosion occurred at Black Elk's West Delta 32 Platform resulting in 3 deaths in one of the worst industrial accidents in modern offshore production history.



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## Black Elk Background

- Facing criminal investigations, negative publicity and civil suits, Platinum Partners is alleged to have commenced a process to drain assets from Black Elk.
- In connection with downsizing its operations, in August 2014, the Debtor closed on a sale of seven (7) operating assets and one (1) non-operating asset to Renaissance Offshore, LLC that netted \$125.1 million in net proceeds.
- Following the closing of the Renaissance Sale, the Debtor repurchased \$96 million of its Senior Notes using proceeds from the sale.

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## Black Elk Background

- In January 2015, the Debtor entered into an additional sale of assets to Northstar Offshore Group, LLC (the “Northstar Sale”) in exchange for the assumption of \$75 million in Senior Notes.
- Northstar was also owned by Platinum Partners.
- In the Spring of 2015, Platinum attempts to convey all remaining operating assets and bonding collateral to TKN Petroleum Offshore LLC – a newly created Platinum Partners entity for no apparent consideration.

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## Black Elk Bankruptcy

- By September 30, 2014, after paying \$96 million to Holders of the Senior Notes, the Debtor was left with a net working capital deficit of approximately \$61.9 million and the company's ability to service its debt was in question.
- After the closing of the Northstar Sale, Black Elk was left with substantial P&A liabilities and little to no liquidity.
- On August 11, 2015, creditors of Black Elk filed an involuntary bankruptcy case against Black Elk. On August 31, 2015, Black Elk filed a consent to the bankruptcy and a conversion to chapter 11.

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## Issues Facing Black Elk

- Shut-Inc Inc Notice: shortly after the involuntary was filed, BSEE issued a Shut In Incident of Noncompliance effectively shuttering Black Elk's remaining operating platforms.
- Lack of Liquidity/operations – unclear if TKN owned remaining assets.
- US Government asserts administrative claim in the potential amount of \$1 billion for decommissioning and environmental damages
- Lingering criminal suit

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## Goals of Bankruptcy

- Assess going concern sale opportunities
- Maximize value for creditors by unlocking major remaining assets
  - \$150 million in P&A Collateral
  - Clawback Suits against Platinum Partners
- Solve US Government administrative claim so value could flow to other creditors

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## P&A Solution

- Negotiated interim funding from predecessors-in-interest to allow time period to seek larger transaction
- Negotiated multiparty DIP with bonding insurers (holding cash collateral), ad hoc committee of Noteholders, predecessors-in-interest, UCC, BOEM/BSEE, Northstar, TKN/Platinum and offshore contractor to free up collateral.
- Closed Northstar transaction freeing P&A collateral

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## Litigation Trust Funding

- Ad Hoc Noteholders provided seed funding for Litigation Trust against Platinum Partners with agreement on split of proceeds of any recoveries with UCC and US Government – forming the basis for plan of liquidation that was approved by the Bankruptcy Court in April 2016.

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## Epilogue

- In August 2016, creditors of Northstar file involuntary chapter 7 forcing Northstar into Bankruptcy
- In late August 2016, a Cayman Islands court ordered the liquidation Platinum Partners flagship hedge fund amid investigations by US authorities
- In December 2016, Platinum Partners' founder and chief Investment Officer among five indicted in an alleged \$1 Billion investment fraud by the US Attorney for the Eastern District of New York

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