



AMERICAN  
BANKRUPTCY  
INSTITUTE

# 2017 New York City Bankruptcy Conference

## Current Issues in the Energy Sector

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## NYC Bankruptcy Conference Current State of the Energy Sector



May 2017

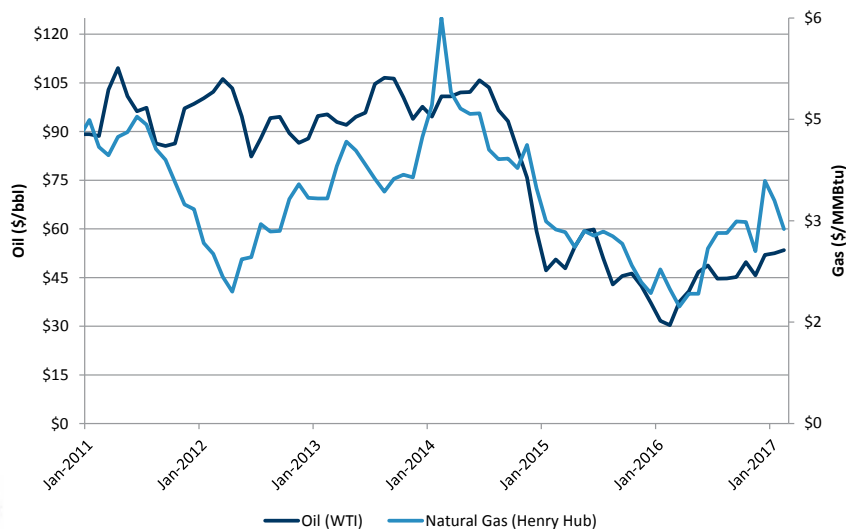
PERKINScoie

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### Industry Overview

#### Commodity Pricing Recovery: E&P's Still Squeezed

- It has been more than two years since OPEC announced it would no longer be the world's swing producer of crude oil. Oil prices retreated below \$27 per barrel before recovering to the mid \$40 range for most of 2016.
- In November 2016, OPEC agreed to cut production for the first time in 8 years, by 1.2 million barrels a day. Most of the members seem to be holding to the production cuts, and oil has held in the low to mid \$50 range.
  - Few analysts expect a meaningful rally beyond current levels in the near future—the median forecast for YE 2017 is \$58.30 for WTI and \$3.28 for Henry Hub.
  - E&P companies have regained access to the capital markets, but few regions are profitable to develop at current prices.



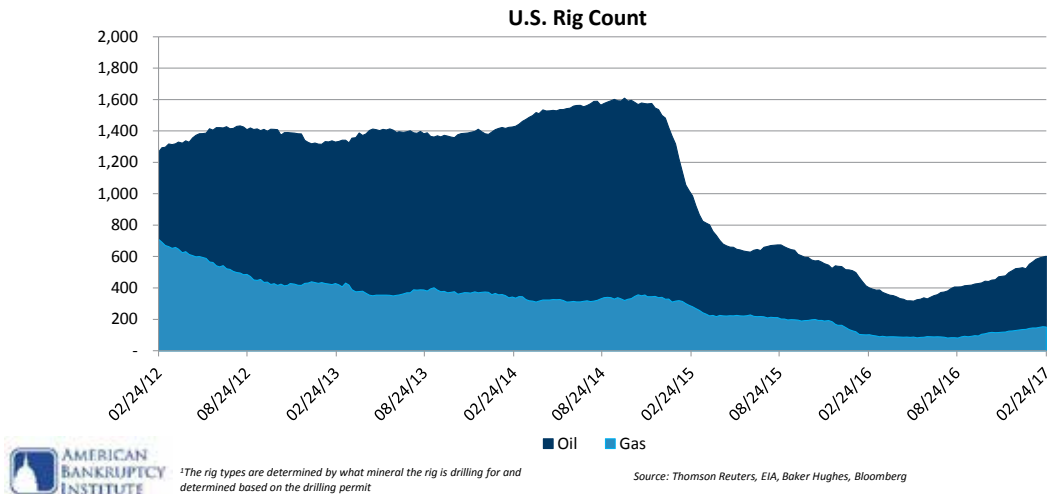
## Industry Overview Total U.S. Rig Count

U.S. drilling rig counts have trended upward since reaching historic lows in mid-year 2016, but remain significantly below levels recorded before the commodity price downturn

- Total active U.S. rig count has steadily increased from the cycle low of 404 in May 2016, to 824 as of March 31, 2017

**Technology Changes also contributing to rig decline**

- Pad drilling, the practice of drilling multiple well bores from one surface location, has boosted rig efficiency
- Many such wells are drilled but uncompleted and are ready to be brought on line in so that production can be ramped up in the case of a price recovery

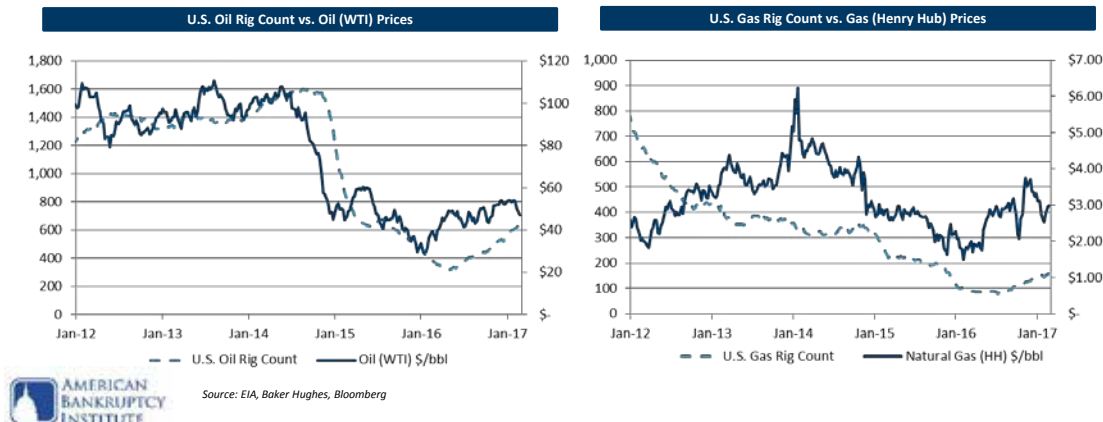


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## Industry Overview U.S. Rig Count Volatility

Since reaching a trough in February 2016, oil prices have moved closely with increases in the U.S. oil rig count

- Rig counts and weekly WTI prices were also highly correlated in the six months preceding the trough.
  - When the price of WTI oil per barrel goes up in a given week, the rig count has trended upward the following week.
  - Conversely, when the rig count goes up in a given week, the price of WTI oil per barrel has trended downward the following week.
- An increasing number of analysts are using the rig count as an explanation for oil price movement, both upwards and downwards.
- Gas prices and gas directed rig counts do not appear to have the same correlation, as gas rig counts have steadily decreased over the last few years.



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## Industry Overview

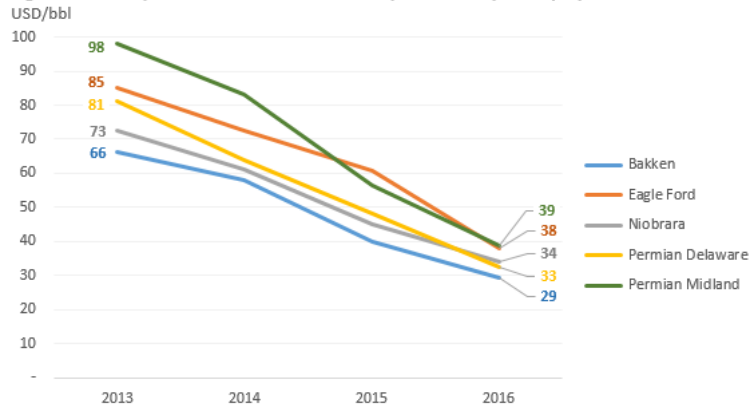
### Breakeven Oil Price Declining

Operators have driven efficiencies into drilling and completion through the use of:

- Faster drill cycle times through better planning, pad drilling and more experience
- Increasing recoveries through longer laterals, optimized completions, better reservoir understanding, high grading acreage
- Negotiating lower rates with suppliers and lower steel prices driving down cost of pipe
- Optimizing infrastructure for efficient salt water disposal, reduced trucking, more takeaway capacity

While wellhead breakeven prices decreased below \$40 for several basins, companies still require a real rate of return after transportation expense to justify investment

Figure 1: Development in wellhead breakeven prices for key shale plays



Source: Rystad Energy NAS/WellCube

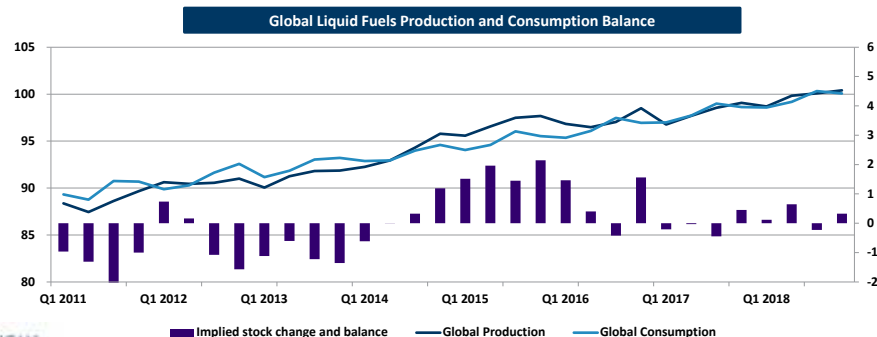
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## Industry Overview

### Global Production and Consumption

- During 2016, world crude oil and liquid fuels was oversupplied by ~800 thousand bpd.
- For 2017, the EIA estimates that average inventory draws will be ~100 thousand bpd.
- With petroleum product demand forecasted to grow at a faster rate in 2017 than in 2016, global oil markets appear closer to balance than recent past.
- The global supply of crude oil and other liquid fuels has steadily increased since the downturn in late 2014, and is forecasted to be 98.0 million Bbl/day in 2017

Global Petroleum & Other Liquids (Million barrels per day)					
	2014	2015	2016	2017	2018
World Production					
Non-OPEC Production	57.2	58.8	58.2	58.5	59.5
OPEC Production	36.6	38.0	39.0	39.5	40.2
Crude Oil Production	30.4	31.6	32.5	32.7	33.2
Other Liquids Production	6.2	6.4	6.5	6.9	7.0
<b>Total World Production</b>	<b>93.8</b>	<b>96.8</b>	<b>97.2</b>	<b>98.0</b>	<b>99.8</b>
World Consumption					
OECD Consumption	45.8	46.3	46.6	47.0	47.3
Non OECD Consumption	47.8	48.7	49.8	51.1	52.3
<b>Total World Consumption</b>	<b>93.6</b>	<b>95.1</b>	<b>96.5</b>	<b>98.1</b>	<b>99.5</b>
<b>Over/ (Under) Supply</b>	<b>0.2</b>	<b>1.8</b>	<b>0.8</b>	<b>(0.1)</b>	<b>0.2</b>

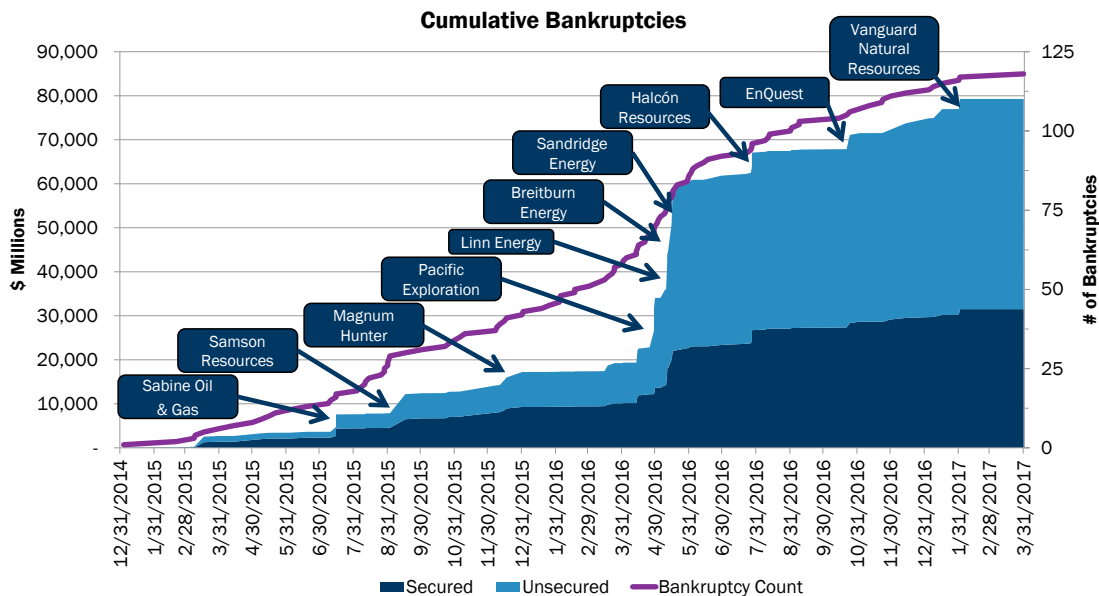


Source: Thomson Reuters, Bloomberg, CME, NYMEX; EIA; IEA (Short Term Energy Outlook – Global Petroleum and Other Liquids)

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## Industry Restructurings E&P Bankruptcies to Date

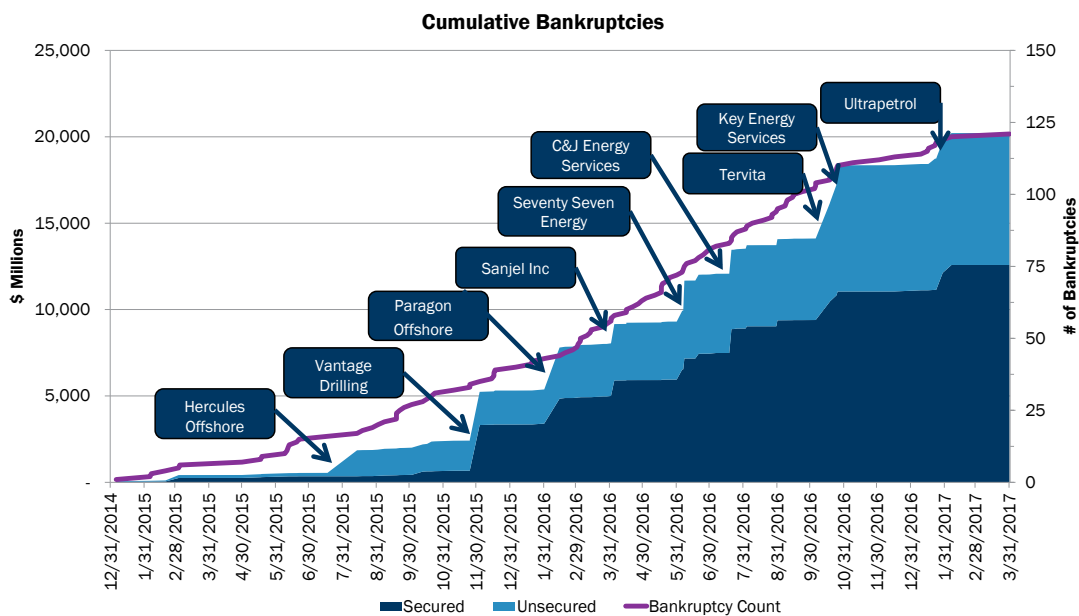


Sources: FTI Consulting analysis; Haynes & Boone Oil Patch Bankruptcy Monitor

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## Industry Restructurings OFS Bankruptcies to Date



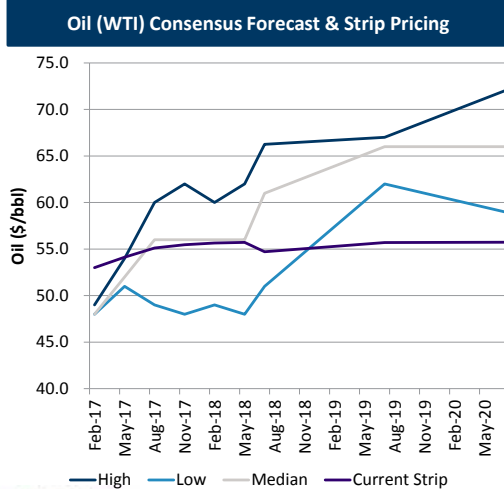
Sources: FTI Consulting analysis; Haynes & Boone Oil Patch Bankruptcy Monitor

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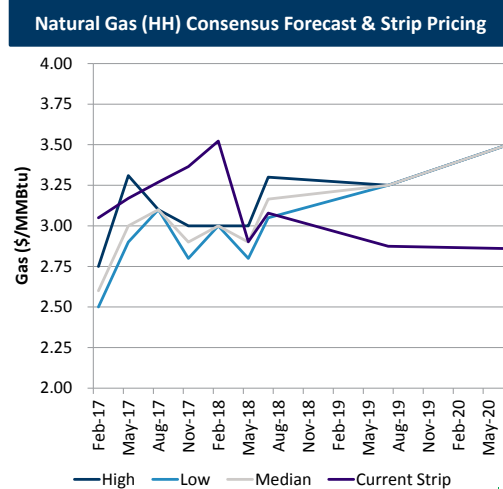
## Market Outlook Oil & Gas Analysts Forecasts

### Commodity Price Forecast

- Analysts across the industry are updating commodity price decks to understand the impact on earnings, cash flow, and net asset values
  - Most analysts polled by Bloomberg expect a slight rally in energy prices through 2017
  - Estimate prices will be in the range of \$50 to \$60 per barrel for WTI and ~\$3.00 per MMBtu for Henry Hub
- Below is a summary of current oil (WTI) and natural gas (HH) price forecasts:



Source: Bloomberg

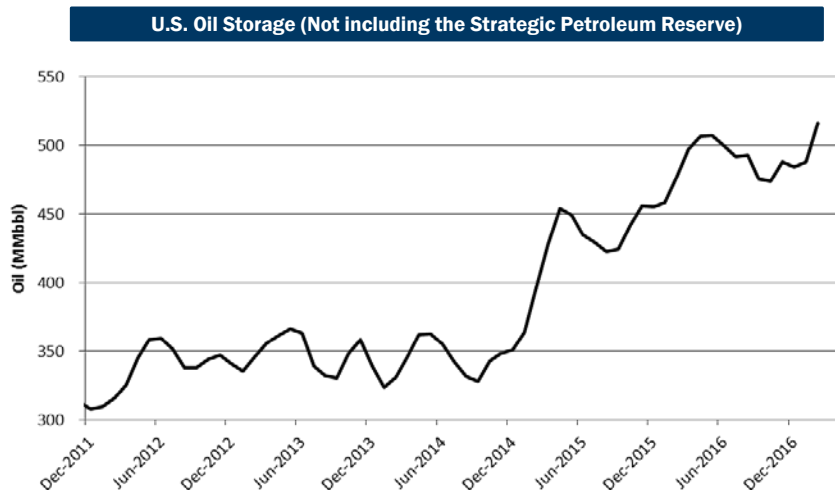


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## Market Outlook Oil Storage Levels Still Near All Time Highs

Oil storage levels peaked in Q1 2017 and remain at all time highs

- It could take a year or more to return to more normalized levels.



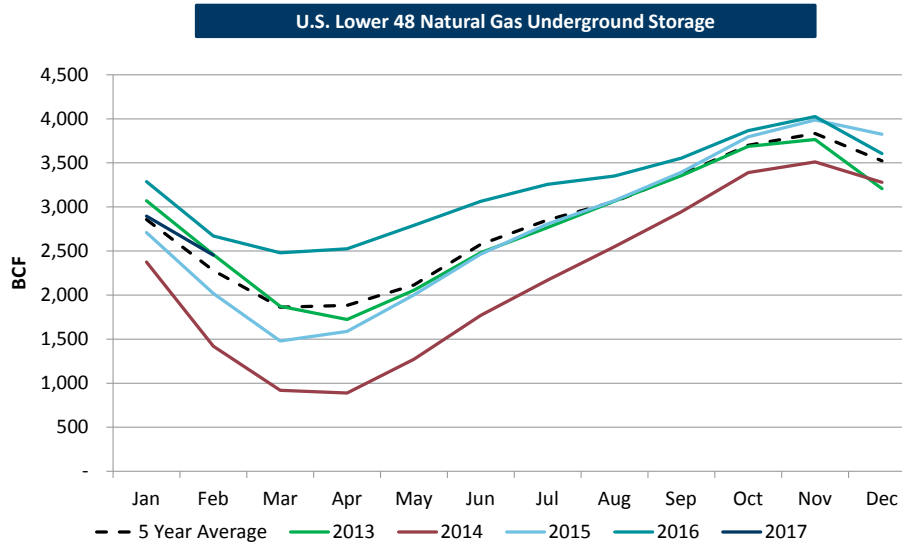
Source: EIA.gov

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## Market Outlook

### Gas Storage Levels—Back on track to 5 Year Average

Natural gas storage levels peaked in 2016 but have come back in line with 5 year average levels



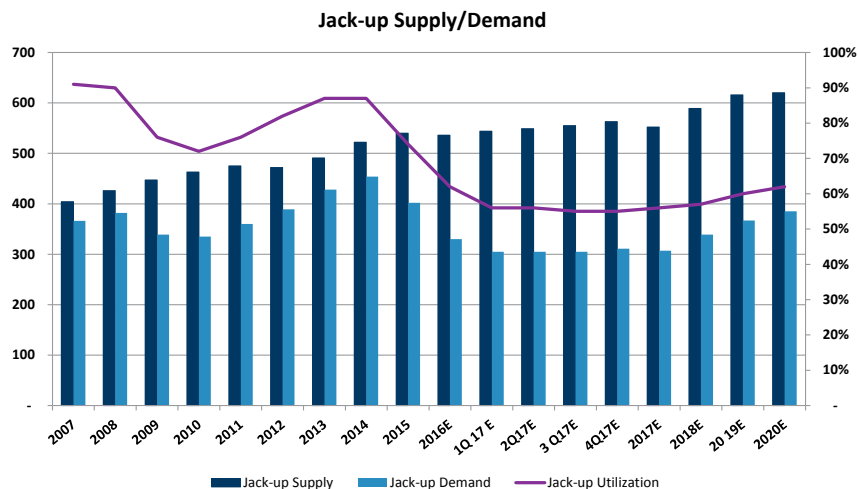
Source: EIA.gov

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## Market Outlook

### Offshore Sector Still Feeling the Pain

- Jack-up rig utilization decreased from a 2014 peak of 454 to 312 in March 2017.
- It is expected to bottom out by 2Q17, but meaningful recovery is not anticipated before late 2018.

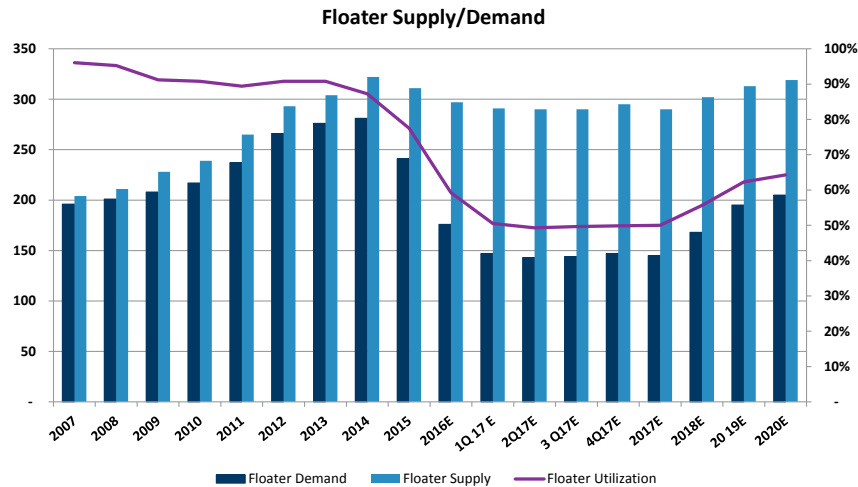


Source: Analyst reports, Company reports

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## Market Outlook Offshore Sector Feeling the Pain

- Floater demand decreased from a 2014 peak of 281 to 151 in March 2017.
- It is expected to bottom out at ~140 in 2Q17, but meaningful recovery is not anticipated before 2019.



Source: Analyst reports, Company reports

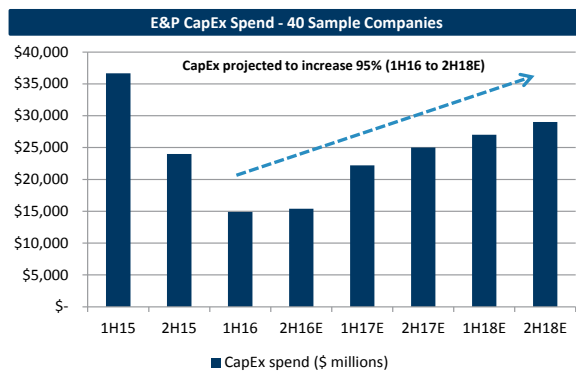
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## Market Outlook Capex Guidance Increasing for 2017

There is an expected increase in Capital Expenditure spend across the E&P sector given the recent increase in pricing, the need for many companies in the sector to grow production and reserves, and more market optimism since OPEC's announcement to cut production.

(\$ in million)

Large-Cap: Company Name	Ticker	2015 A	2016 E	2017 E
Apache Corp	APA	\$ 5,178	\$ 1,994	\$ 3,042
Anadarko Petroleum Corp	APC	6,067	3,250	4,443
Chesapeake Energy Corp	CHK	3,771	1,621	2,084
Continental Resources	CLR	264	1,115	1,886
Devon Energy Corp	DVN	5,308	2,122	2,544
EOG Resources Inc	EOG	5,013	2,628	4,104
Noble Energy Inc	NBL	2,979	1,502	2,344
Pioneer Natural Resources	PXD	2,393	2,106	2,687
<b>Total CapEx</b>		<b>\$ 30,973</b>	<b>\$ 16,339</b>	<b>\$ 23,133</b>



(\$ in million)

Mid-Cap: Company Name	Ticker	2015 A	2016 E	2017 E
Antero Resources Corp	AR	\$ 2,348	\$ 1,815	\$ 1,642
Cabot Oil & Gas Corp	COG	956	379	636
Cimarex Energy Co	XEX	1,050	742	991
Concho Resources Inc	CXO	2,511	1,272	1,563
EP Energy Corp	EPE	1,433	512	542
EQT Corp	EQT	2,434	1,616	1,995
Diamondback Energy Inc	FANG	902	370	1,062
Gulfport Energy Corp	GPOR	1,593	582	1,274
Laredo Petroleum Inc	LPI	633	405	508
Newfield Exploration Co	NFX	1,745	804	1,090
Oasis Petroleum	OAS	849	413	500
QEP Resources Inc	QEP	1,239	559	906
Range Resources Corp	RRC	1,035	541	946
Rice Energy Inc	RICE	1,246	919	1,414
RSP Permian Inc	RSP	873	340	599
SM Energy Co	SM	1,502	686	822
Southwestern Energy Co	SWN	1,798	697	1,046
Whiting Petroleum Corp	WLL	2,497	539	760
<b>Total CapEx</b>		<b>\$ 26,643</b>	<b>\$ 13,191</b>	<b>\$ 18,297</b>



Source: Wells Fargo Securities estimates, Company Filings, and Bloomberg LP

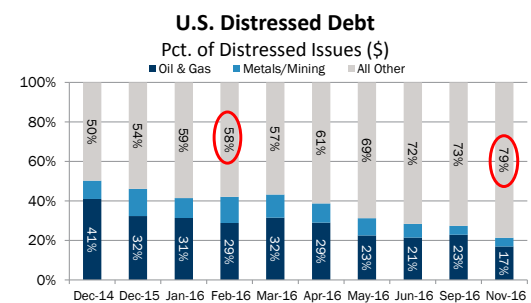
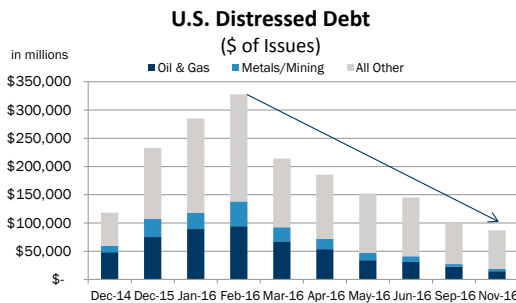
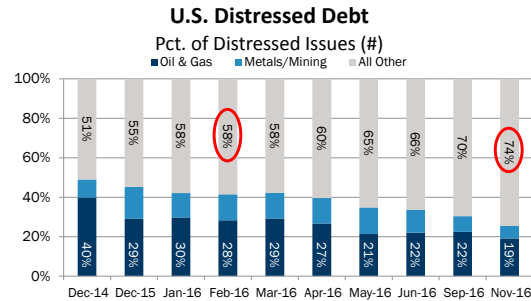
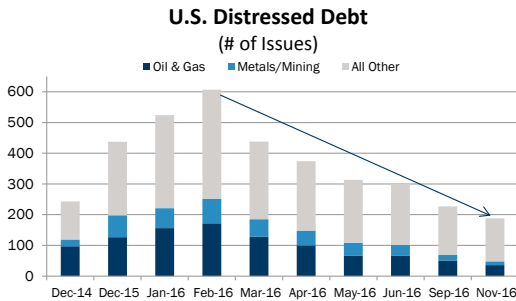
2016 and 2017 CapEx guidance is estimated based on Bloomberg and Wells Fargo estimates

A = Actual; E = Estimate

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## Return of Capital to the Sector Distress Debt Levels Have Fallen Sharply Across Industry Sectors

- Relative proportion of distressed debt attributable to the energy/metals/mining sectors has fallen by 50% since February.



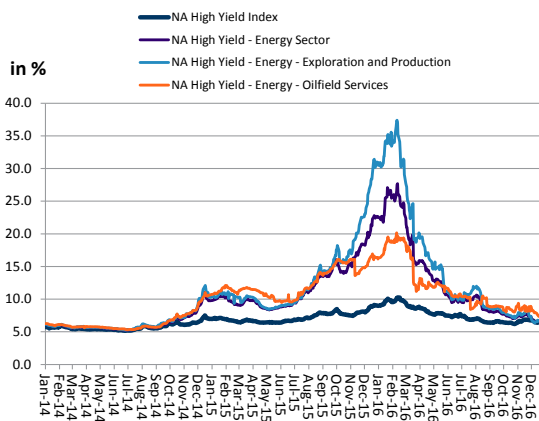
Note: A debt issue is considered distressed by S&P if its market trading spread over a comparable Treasury security exceeds 1,000 basis points.

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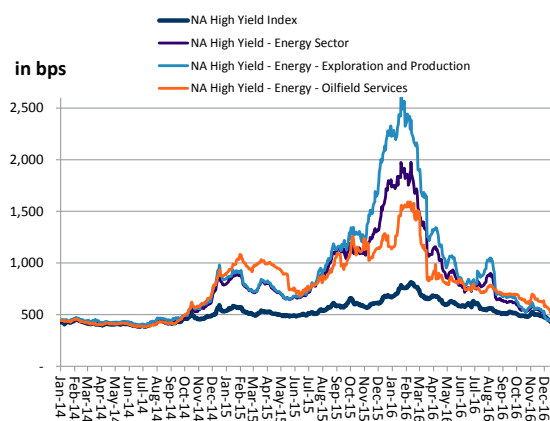
## Return of Capital to the Sector HY Energy Stages a Huge Comeback Despite Sector Challenges

- High-yield bond spreads in the North American energy sector have contracted by 1,200 bps since February 2016 while overall high yield spreads have fallen by 500 bps in that time.
- High-yield investors appear undaunted by ongoing challenges that still persist in the energy sector notwithstanding the rebound in oil prices off their lows of a year ago.

**U.S. High Yield Index: Yield-to-Worst**



**U.S. High Yield Index: Spread-to-Worst**

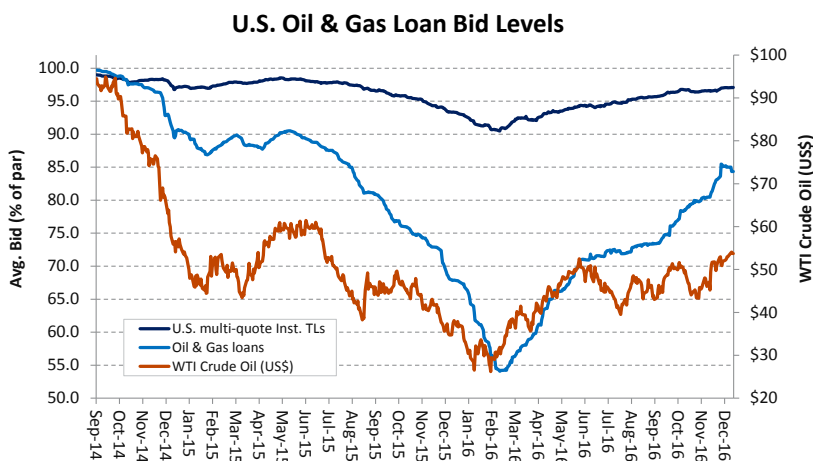


Source: AdvantageData.com

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## Return of Capital to the Sector Energy Sector Leveraged Loans In Recovery

- Leveraged institutional terms loans have, on average, recovered to 97 cents in secondary markets from earlier lows of 90 in February 2016.
- Energy-related terms loans have rallied too—to 86 cents on average from lows of 55 cents in February 2016—a 54% rebound.



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## Bankruptcy Issues E&P Lessons Learned

As of January 2017 there were 170 bankruptcy filings in the energy sector (E&P and O&G) since January 2015<sup>(1)</sup>. The 103 bankruptcies in the E&P space represented ~\$70.1B in total debt filed.

The following are lessons learned by lender groups from this down-cycle and opportunities to prepare for the next one:

- Place liens on 95% of the PV-10 value of proved reserves. Typically, 80-85% of the PV-10 value is subject to liens.
  - Periodically check the status of liens to ensure they are up to date
  - In some cases, only second liens may be available due to complex capital structures.
- Obtain DACAs (Deposit Account Control Agreements) on all of a company's bank accounts.
- Include anti-cash hoarding language in all credit agreements.
- Incorporate wild card redeterminations credit agreements. In periods of declining prices, banks should not be afraid to exercise redetermination rights.
- Hedging agreements should include language that allows an offset against all creditors in the revolving facility, rather than just the bank providing the hedge. In cases where the bank's hedge value is greater than its portion of the facility, this type of language will prevent leakage when hedges are terminated.
- Ensure all new credit agreements include a provision allowing the agent to retain a financial advisor at the expense of the borrower upon the occurrence of any covenant violation or breach.



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## Bankruptcy Issues

### Shoreline Takeaways: Can't Neglect P&A Obligations

**The Shoreline Energy bankruptcy case set a precedent disallowing companies from leaving a shell company with P&A obligations that cannot be satisfied.**

- Shoreline Energy filed for bankruptcy in the Southern District of Texas in November 2016.
- Stalking horse bidder planned to leave the Company with shut-in, uneconomic wells without the capital to plug and abandon the wells.
- State of Louisiana objected to the Plan because there would be no capital to plug and abandon the wells remaining at OldCo.
- Judge Jones sided with the State and determined that the Plan was un-confirmable in its current form because it did not satisfy the Bankruptcy Code.
- The Plan was modified to set aside funds to P&A the wells in question, and plan confirmation moved forward.



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## Bankruptcy Issues

### Sabine – Where are we now?

**Recap:**

- Sabine enters into midstream agreements with 2 counterparties -- Sabine agrees to deliver a minimum volumes of oil, natural gas, condensate or water produced from certain dedicated areas for gathering, treatment and redelivery.
- Minimum volume commitment or "MVC" -- if Sabine doesn't meet MVC, it must pay deficiency fee to counterparty.
- Agreements purport to create covenants running with the land or "CRWL" under TX law; however, Sabine retained title to underlying mineral leases.
- Sabine files chapter 11 and seeks to reject the agreements -- motion practice under §365 and an adversary proceeding seeking declaratory relief by both sides.
- May 2016 -- Bankruptcy Court authorizes rejection, concluding (a) that the agreements did not create CRWL under Texas law, (b) if horizontal privity between the parties is required to create a CRWL under Texas law, that privity was lacking in the Sabine dispute, and (c) that the agreements did not create equitable servitudes under Texas law.
- March 13, 2017 -- District Court affirmed Bankruptcy Court's orders authorizing rejection of the midstream agreements

**District Court Undertook a Texas Law Analysis**

**CRWL exists under Texas law when:**

- 1. Touches and concerns the land;
- 2. Relates to a thing in existence or specifically binds the parties and assigns;
- 3. The original parties intend to make the covenant run with the land; and
- 4. A successor to the burden has notice.
- The Plan was modified to set aside funds to P&A the wells in question, and plan confirmation moved forward.

**On appeal, the parties only disputed the 1st factor -- touch and concern the land.**



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## Bankruptcy Issues

### Sabine – What the heck does “touch and concern” mean?

**Texas Supreme Court has outlined 2 tests:**

- 1. Touches and concerns land if it affects the nature, quality or value of the thing demised, independently of collateral circumstances, or if it affects the mode of enjoying it.
- 2. Touches and concerns land if either the promisor’s legal relations in respect to the land are lessened OR the promisee’s legal relations in respect to the land are increased.

**Alternative tests – meeting either one will suffice.**

**District Court first considered the 2nd test:**

- Appellants did not show that the agreements increased their legal relations to the real property interest or decreased Sabine’s legal relations to the subject real property.
- Agreements did not create any mineral right recognized under Texas law:
  - 1. No right to develop conveyed;
  - 2. No right to lease conveyed;
  - 3. No right to receive bonus payments conveyed;
  - 4. No right to receive delay rentals conveyed;
  - 5. No right to receive royalty payments conveyed.

**Therefore, no “increase” in the appellants’ relative real property rights.**

**District Court also concluded that the midstream agreements did not diminish Sabine’s legal relation to its real property:**

- • Failure to meet MVC created a mere contract obligation to make deficiency payments
- • Deficiency payment ≠ limit on Sabine’s enjoyment of the land itself



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## Bankruptcy Issues

### Sabine – What the heck does “touch and concern” mean?

**District Court next considered 1st test for “touch and concern”:**

- • No restriction on Sabine’s ability to make use of its real property interest
- • No restriction on Sabine’s ability to alienate its real property interest
- • Any diminution in property value resulting from MVC is merely “collateral” to the terms of the agreements and would affect any mineral-producing property

**Court concluded that the agreements did not affect the nature, quality or value of Sabine’s real property interest, or Sabine’s ability to enjoy its real property interest**

**District Court: Appellants failed to demonstrate that their agreements meet either TX law test, so the agreements do not touch and concern the land.**

- • Unlike the Bankruptcy Court, the District Court did not address whether horizontal privity is an additional CRWL requirement under Texas law, or whether horizontal privity existed on the facts of Sabine
- • No need to address privity when appellants failed both “touch and concern” tests .



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## Bankruptcy Issues

### Sabine – What the heck does “touch and concern” mean?

Court next rejected appellants’ equitable servitude (“ES”) argument.

- Under Texas law, covenant can bind successors as an ES without meeting CRWL requirements if:
  - 1. The successor took its interest with notice of the covenant;
  - 2. The covenant limits the use of the burdened land; and
  - 3. The covenant benefits the land of the party seeking to enforce the covenant.

Court had already concluded that the agreements did not burden Sabine’s land = appellants cannot establish 2nd factor

Court also concluded that the agreements benefit only the appellants, and not any land owned by the appellants = appellants cannot establish 3rd factor

The takeaway?

- Midstream companies and their clever transactional lawyers are trying to add bells and whistles to make sure that their agreements create something that is (or looks like) a true mineral interest under applicable law
- E&P companies, E&P lenders and their clever transactional lawyers are pushing back to try to water down impact of MVC provisions
- Similar issue is now teed up in the Southern District of Texas -- *Vanguard vs. Encana*
- Vanguard seeks dismissal of Encana’s declaratory judgment action, arguing no intent to create CRWL and no horizontal privity
- Stay tuned...



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## Bankruptcy Issues

### The Rise of Equity Committees

It is not unusual for preferred and common unitholders to request the appointment of an equity committee to represent their interests in chapter 11 cases. However, the appointment of an equity committee is extraordinary relief and Bankruptcy Courts usually deny such requests.

- Equity-holders have an affirmative burden of establishing:
  - That there is a substantial likelihood of a meaningful distribution to equity holders; and
  - That equity is not adequately represented.
- Recent cases in which equity holders sought appointment of an equity committee and the Court denied the requested relief:
  - *In re Paragon Offshore PLC*, case no. 16-10386 (Bankr. D. Del. Mar. 28, 2017)
  - *In re Peabody Energy Corp.*, case no. 16-42529 (Bankr. E.D. Mo. Jan. 20, 2017)
  - *In re SunEdison, Inc.*, case no. 16-10992 (Bankr. S.D.N.Y. Aug. 12, 2016 )
  - *SandRidge Energy, Inc.*, case no. 16-32488 (Bankr. S.D. Tex May 16, 2016)

Nevertheless, there have been recent equity committee appointments in the oil and gas space as a result of some bankruptcy courts looking beyond the usual factors and considering issues such as the recognition of taxable cancellation-of-debt income by unitholders in a MLP structure without an offsetting ordinary deduction.

- *In re Energy XXI Ltd.*, case no. 16-31928 (Bankr. S.D. Tex. Aug. 12, 2016)
- *Hercules Offshore, Inc.*, case no. 15-11685 (Bankr. D. Del. Jun. 5, 2016)
- *In re Breitburn Energy Partners, LP*, case no. 16-11390 (Bankr. S.D.N.Y. Oct. 14, 2016)

In cases where equity committees have been appointed, courts often narrow the scope of the committee and impose other cost-conscious safeguards.

A number of debtors also have negotiated additional recoveries in lieu of a court decision on equity committee formation.



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## Bankruptcy Issues

### Valuation Considerations in E&P Spaces

Valuation is the starting point for evaluating chapter 11 outcomes. There are various valuation methodologies utilized by financial advisors, the degree to which different methodologies are relied upon depends on a number of factors, the following present generally accepted E&P industry methodologies:

	DESCRIPTION
<b>NET ASSET VALUE ("NAV") ANALYSIS</b>	<ul style="list-style-type: none"> <li>An NAV analysis values an asset or business by calculating the present value of unlevered free cash flows generated by the proved reserves and probable and possible reserve potential</li> <li>Projected unlevered free cash flows in the analysis are derived from the company's projections using strip pricing curves                             <ul style="list-style-type: none"> <li>The projected cash flows are then discounted by the industry standard rate of 10% and the discounted cash flows are further risk adjusted by applying relative probability weighting or a reserve adjustment factor commensurate with the geological riskiness of the category</li> </ul> </li> <li>The resulting present value of future cash flows is then netted against the present value of projected general and administrative expense</li> </ul>
<b>COMPARABLE COMPANY ANALYSIS</b>	<ul style="list-style-type: none"> <li>The comparable company method estimates the value of a company based on the implied valuations of other publicly traded companies with relatively similar business and financial characteristics</li> <li>The financial advisor's analysis of the potential comparable companies includes a review of each company's financial statements, as well as an assessment of each company's asset base, geography, reserve characteristics, size and scale of operations, among other things                             <ul style="list-style-type: none"> <li>Financial advisor may make certain necessary qualitative assessments concerning differences between the characteristics of Expro and potential comparable companies</li> </ul> </li> <li>The enterprise values of the comparable companies may be expressed as multiples of Revenue, EBITDA, daily production, and reserves, among others                             <ul style="list-style-type: none"> <li>A range of these multiples may then be applied to Expro to imply an estimate of the value of the reorganized enterprise</li> </ul> </li> </ul>
<b>PRECEDENT TRANSACTION ANALYSIS</b>	<ul style="list-style-type: none"> <li>The precedent transaction method estimates the value of a company by examining M&amp;A transactions for comparable companies and analyzing the purchase price (including debt) as a multiple of various operating statistics</li> <li>A multiple range (e.g., Transaction Value to Proved Reserves, Transaction Value to Daily Production, etc.) is then applied to the Company's metrics to arrive at an estimation of valuation                             <ul style="list-style-type: none"> <li>This method also requires qualitative judgments as each M&amp;A transaction occurs under unique circumstances</li> <li>The selection of comparable transactions is subject to limitations such as sample size, differing commodity price environments, and differing asset characteristics, among others</li> </ul> </li> </ul>

Valuation in the E&P space has unique challenges given the volatility of the commodities market. For example, a rally in crude oil that has driven spot and forward prices north may render a debtor's valuation into question.



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## Bankruptcy Issues

### Valuation Considerations in E&P Spaces (cont'd)

Valuation disputes in the context of plan confirmation, whereby parties-in-interest contest the debtor's valuation for various reasons, including the use of a flawed valuation, have been the subject of recent litigation.

We will discuss valuation issues and key topics from the following cases.

- In re Paragon Offshore PLC*, case no. 16-10386 (Bankr. D. Del. 2016).
- In re Ultra Petroleum Corp.*, case no. 16-32202 (Bankr. S.D. Tex 2016).
- In re C&J Energy Services Ltd.*, case no. 16-33595 (Bankr. S.D. Tex 2016).
- In re Energy XXI Ltd.*, case no. 16-31928 (Bankr. S.D. Tex. 2016).
- In re Sabine Oil & Gas Corp.*, case no. 15-11835 (Bankr. S.D.N.Y. 2015).
- In re Linn Energy, LLC*, case no. 16-60040 (Bankr. S.D. Tex 2016).



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## Bankruptcy Issues Prevalent Litigated Issues

With the uptick in chapter 11 filings since January 2015, there are certain reoccurring litigable issues:

- **Enforceability of “make-whole” provisions**
  - Aftershocks of the decision in *In re MPM Silicones, LLC*, case no. 14-22503, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff’d*, 531 B.R. 321 (S.D.N.Y. 2015) (Currently under advisement before the Second Circuit).
  - In deciding whether make-whole provisions are enforceable in bankruptcy, Courts generally undertake 3 levels of analysis:
    - Whether the governing debt document, on its terms, provides for a prepayment premium under the existing facts.
    - Whether the right to a prepayment premium exists under the governing non-bankruptcy law, which is usually also state law.
    - Whether the right that exists under applicable non-bankruptcy law gives rise to an allowed claim under the Bankruptcy Code
  - Recent cases serve as a reminder of the importance of carefully drafting make-whole provisions
    - For example, *Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. Nov. 17, 2016).
- **Ability to reject Pipeline or Gas Gathering Agreements**
  - In *In re Sabine Oil & Gas Corp.*, 2016 BL 70494 (Bankr. S.D.N.Y. Mar. 8, 2016), the Bankruptcy Court held that the debtor could reject its gas gathering agreements because its midstream counter-parties could not establish that their agreements were covenants running with the land under Texas law.
- **The interaction of the deadline to extend non-residential real property leases pursuant section 365(d)(4) of the Bankruptcy Code.**



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## Bankruptcy Issues Prevalent Litigated Issues (cont’d)

- **Lien perfection issues unique to E&P industry**
  - E&P companies typically pledge all of their assets to obtain secured lending, including the oil and gas properties. “Oil and Gas Properties” are generally real property interests – liens on such interests must be perfected through mortgages.
  - It is critical to understand the scope of encumbered v. unencumbered assets.
    - Procedures for filing mortgages vary from state-to-state and even county-to-county. It is important to perform an exhaustive review of mortgages and perfection filings.
    - The results of the perfection review process will be necessary to determine preference exposure and provide answers to challenges to the debtor’s collateral package.
  - The primary goal of the review process is to confirm that leases are mortgaged, thus preventing value leakage from in-the-money creditors to creditors that will not be entitled to distributions based on the value of the debtor’s assets.
  - Junior creditors and debtors have found added leverage due to potentially large amounts of unencumbered assets in oil and gas cases.
  - The interaction of “safe harbor” protections to avoid actions is a key issue to be considered by debtors and creditors.
- **Forward Hedge Contracts of Oil and Gas Production**
  - Many E&P companies enter into hedge agreements to offset or limit risks associated with volatile oil and gas prices.
  - Those hedge agreements are subject to the safe harbor protections available under the Bankruptcy Code.
  - Hedges can provide a significant pool of capital.
    - Out of bankruptcy, credit agreement permits swap proceeds to be generated without a redetermination up to 10% of the borrowing base but subject to \$25M excess cash sweep.
    - In bankruptcy, it is possible to use all proceeds of swap terminations subject to providing adequate protection to lenders.
  - In E&P debt workouts, in-the-money hedge portfolios can be a major source of leverage for borrowers and, in certain circumstances, for Lenders.
  - The complexity of hedge-related legal disputes and the strong disincentives to litigate over hedge proceeds at the beginning of a Chapter 11 case generally results in negotiated outcomes, which may form the basis for a global resolution of a borrower’s financing needs.



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