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Issues Facing Unsecured Creditors/Contract Litigation in the Oilfield

April 15, 2020

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Our Speakers



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Topics for Today

- Get Ready for the Ride
- Unsecured Creditors' Committee Issues
- Contested Matters and Adversary Proceedings
- Recent Bankruptcy Issues Associated with Producer/Midstream Relationships
- Disputed Issues Associated with Safe Harbor Contracts

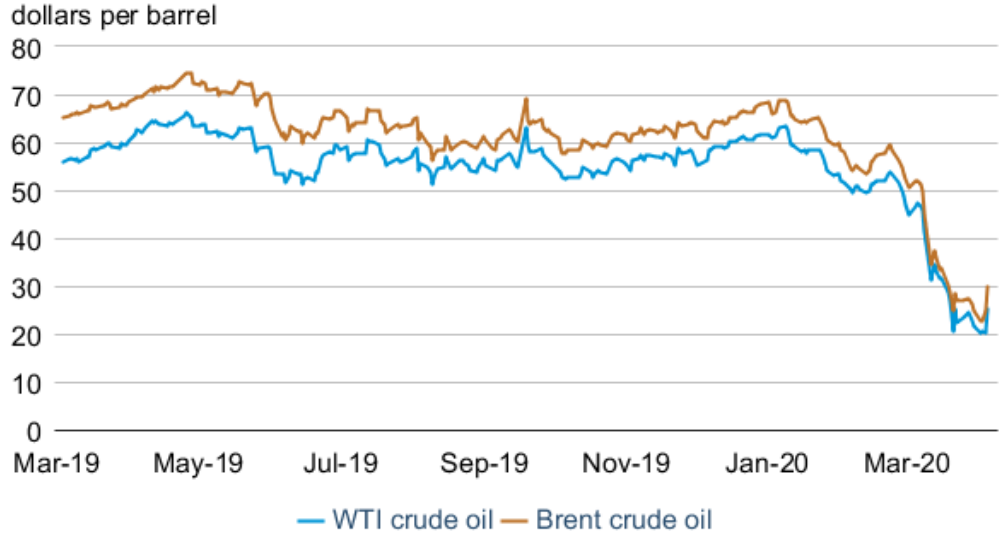
Get Ready for the Ride



Daily Herald, Six Flags announces new opening for Goliath wooden roller coaster *available at* <https://www.dailyherald.com/article/20140614/news/140618995/>

Get Ready for the Ride

Figure 1. Crude oil front-month futures prices



eia CME Group and Intercontinental Exchange, as compiled by Bloomberg L.P.; WTI=West Texas Intermediate



Get Ready for the Ride

March 23, 2020



March 24, 2020



April 1, 2020



April 1, 2020

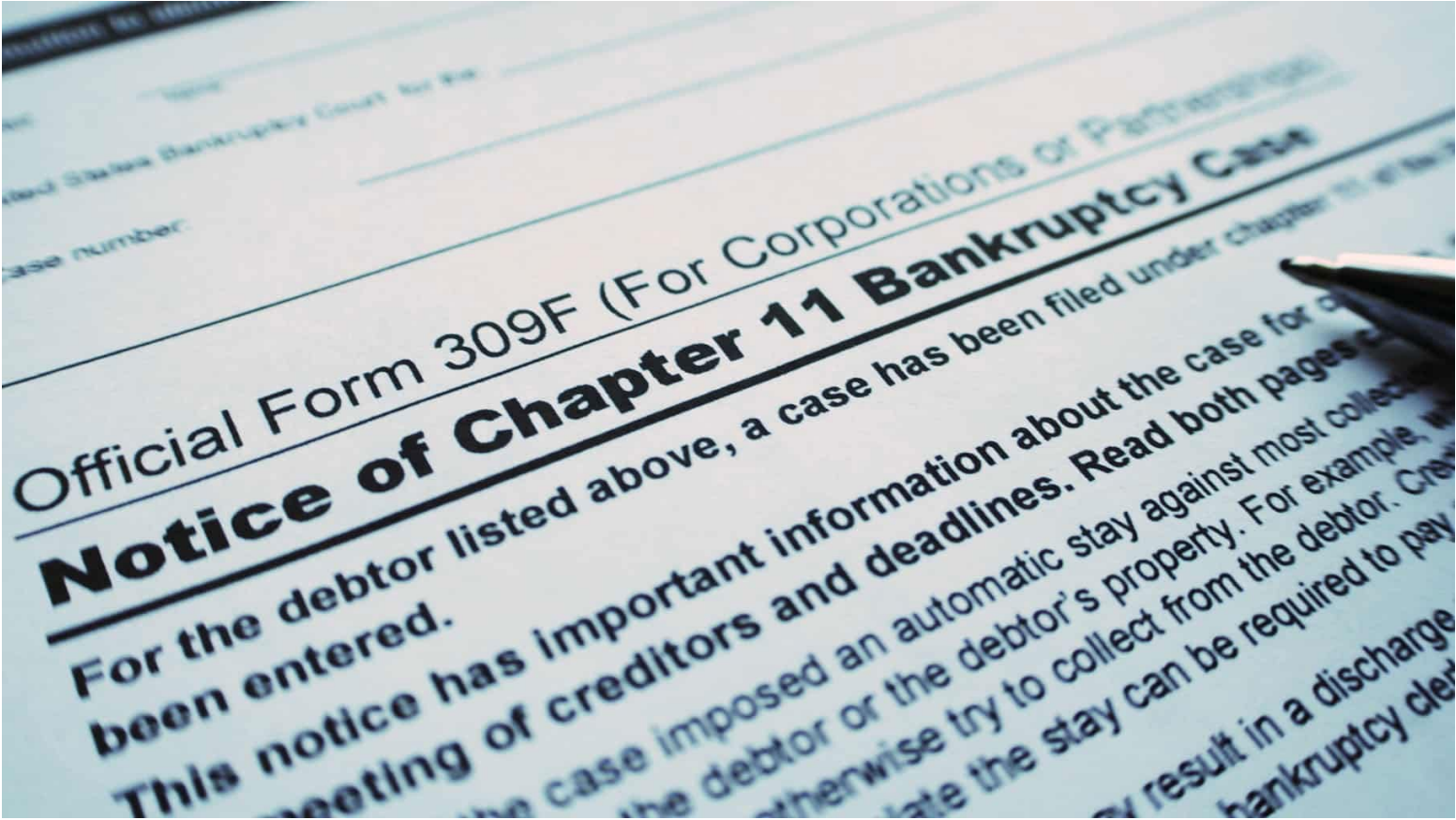


And more to come...

Unsecured Creditors' Committee



Notice of Bankruptcy



Proof of Claim

B10 (Official Form 10) (04/13)

UNITED STATES BANKRUPTCY COURT		PROOF OF CLAIM
Name of Debtor:	Case Number:	<p>NOTE: Do not use this form to make a claim for an administrative expense that arises after the bankruptcy filing. You may file a request for payment of an administrative expense according to 11 U.S.C. § 503.</p> <p>Name of Creditor (the person or other entity to whom the debtor owes money or property):</p>
<p>NOTE: Do not use this form to make a claim for an administrative expense that arises after the bankruptcy filing. You may file a request for payment of an administrative expense according to 11 U.S.C. § 503.</p>		
<p>Name and address where notices should be sent:</p>		
Telephone number:	email:	<p>COURT USE ONLY</p> <p><input type="checkbox"/> Check this box if this claim amends a previously filed claim.</p> <p>Court Claim Number: _____ (If known)</p> <p>Filed on: _____</p> <p><input type="checkbox"/> Check this box if you are aware that anyone else has filed a proof of claim relating to this claim. Attach copy of statement giving particulars.</p>
Name and address where payment should be sent (if different from above):		
Telephone number:	email:	
<p>1. Amount of Claim as of Date Case Filed: \$ _____</p> <p>If all or part of the claim is secured, complete item 4.</p> <p>If all or part of the claim is entitled to priority, complete item 5.</p> <p><input type="checkbox"/> Check this box if the claim includes interest or other charges in addition to the principal amount of the claim. Attach a statement that itemizes interest or charges.</p>		
<p>2. Basis for Claim: _____ (See instruction #2)</p>		
3. Last four digits of any number by which creditor identifies debtor:	3a. Debtor may have scheduled account as: _____ (See instruction #3a)	3b. Uniform Claim Identifier (optional): _____ (See instruction #3b)
<p>4. Secured Claim (See instruction #4)</p> <p>Check the appropriate box if the claim is secured by a lien on property or a right of setoff, attach required redacted documents, and provide the requested information.</p> <p>Nature of property or right of setoff: <input type="checkbox"/> Real Estate <input type="checkbox"/> Motor Vehicle <input type="checkbox"/> Other _____</p> <p>Describe: _____</p> <p>Value of Property: \$ _____</p> <p>Annual Interest Rate _____ % <input type="checkbox"/> Fixed or <input type="checkbox"/> Variable (when case was filed)</p> <p>Amount of arrearage and other charges, as of the time case was filed, included in secured claim, if any: \$ _____</p> <p>Basis for perfection: _____</p> <p>Amount of Secured Claim: \$ _____</p> <p>Amount Unsecured: \$ _____</p>		
<p>5. Amount of Claim Entitled to Priority under 11 U.S.C. § 507 (a). If any part of the claim falls into one of the following categories, check the box specifying the priority and state the amount.</p> <p><input type="checkbox"/> Domestic support obligations under 11 U.S.C. § 507 (a)(1)(A) or (a)(1)(B) <input type="checkbox"/> Wages, salaries, or commissions (up to \$12,475*) earned within 180 days before the case was filed or the debtor's business ceased, whichever is earlier - 11 U.S.C. § 507 (a)(4) <input type="checkbox"/> Contributions to an employee benefit plan - 11 U.S.C. § 507 (a)(5) <input type="checkbox"/> Amount entitled to priority: \$ _____</p> <p><input type="checkbox"/> Up to \$2,775* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507 (a)(7) <input type="checkbox"/> Taxes or penalties owed to governmental units - 11 U.S.C. § 507 (a)(8) <input type="checkbox"/> Other - Specify applicable paragraph of 11 U.S.C. § 507 (a)(_____) <input type="checkbox"/> Amount entitled to priority: \$ _____</p>		
<p>*Amounts are subject to adjustment on 4/01/16 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.</p>		
<p>6. Credits. The amount of all payments on this claim has been credited for the purpose of making this proof of claim. (See instruction #6)</p>		

any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of security agreements, or, in the case of a claim based on an open-end or revolving consumer credit agreement, a copy of the account statement. If the claim is secured, base it on an open-end or revolving consumer credit agreement, a copy of the account statement, and a copy of the account statement. If the claim is secured by a lien on property, attach a copy of the mortgage or deed of trust. If the claim is secured by a lien on property, attach a copy of the mortgage or deed of trust. If the claim is secured by a lien on property, attach a copy of the mortgage or deed of trust.

4. SECURED DOCUMENTS MAY BE DESTROYED AFTER SCANNING.

secured if the creditor owes the right to setoff.

Acknowledgment of Filing of Claim. To receive acknowledgment of your filing, you may either enclose a stamped self-addressed envelope and court PACER system (www.pacer.uscourts.gov) for a small fee to view your filed proof of claim.

Priority Under 11 U.S.C. § 507. Certain categories of secured claims. One or more of these entities may contact the creditor and offer to purchase the claim. Some of the written communications from these entities may be confidential with official court documents. The creditor has no obligation to sell its claim. However, if the creditor decides to sell its claim, any applicable provisions of the Bankruptcy Code (11 U.S.C. § 101 et seq.), and any applicable orders of the bankruptcy court.

INSTRUCTIONS FOR PROOF OF CLAIM FORM

Instructions for the filer. In certain circumstances, such as bankruptcy cases not filed voluntarily by the debtor, this form is to be completed in Proof of Claim form.

Claim is entirely unsecured. (See Definitions.) If the claim is secured, check the box for the nature and value of property that secures the claim, attach copies of documents, and state, as of the date of the bankruptcy filing, the amount interest rate (and whether it is fixed or variable), and the amount past due on the claim.

6. Amount of Claim Entitled to Priority Under 11 U.S.C. § 507 (a). If any portion of the claim falls into any category shown, check the appropriate box(es) and state the amount entitled to priority. (See Definitions.) A claim may be partly priority and partly non-priority. For example, in some of the categories, the law limits the amount entitled to priority.

7. Documents. Attach redacted copies of any documents that show the debt exists and a lien on an open-end or revolving consumer credit agreement or secured by a security interest in the debtor's principal residence. You may also attach a summary in on-delivering health care goods or services. FRBP 3001(c) and (d). If the claim is based on health care goods or services, attach disclosing confidential health care information. Do not send original documents, as attachments may be destroyed.

8. Date and Signature. The individual completing this proof of claim must sign and date it. FRBP 9011 local rules specifying what constitutes a signature. If you sign this form, you declare under penalty of perjury that the information provided is true and correct to the best of your knowledge, information, and reasonable belief. Your signature is a certification that the claim meets the requirements of FRBP 9011(b). Whether the claim is filed electronically or in person, if your name is on the signature line, you are responsible for the declaration. Print the name and title, if any, of the creditor or other person authorized to file the claim. Sign the filer's address and telephone number if it differs from the address given on the top of the form for purposes of receiving notices. If the claim is filed by an authorized agent, provide both the name of the individual filing the claim and the name of the agent. If the authorized agent is a service, identify the corporate service as the company. Criminal penalties apply for making a false statement on a proof of claim.

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Unsecured Creditors Committee - Formation



Unsecured Creditors Committee - Powers



Unsecured Creditors Committee - Cost



Unsecured Creditors Committee - Benefits

{in·flu·ence} *v.*

To affect the nature, development,
or condition of;

Unsecured Creditors Committee – Fiduciary Duty

FIDUCI - WHAT?

Unsecured Creditors Committee – Time Commitment



Unsecured Creditors Committee – Litigation



Delaware Bankruptcies – Contested Matters and Adversary Proceedings



Contested Matter or Adversary Proceeding

- The Bankruptcy Code identifies the types of disputes that are adversary proceedings (Fed. R. Bankr. P. 7001).
- Any other dispute is a contested matter (Fed. R. Bankr. P. 9014(a)).

Both adversary proceedings and contested matters:

- Permit discovery.
- Allow testimony from witnesses.
- Require findings of fact and conclusions of law by the court.

Discovery without Adversary or Contested Matter

- The Rule 2004 Exam “may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor’s estate, or to the debtor’s right to a discharge.” (Fed. R. Bankr. P. 2004(b))

Adversary Proceeding

- Governed by Part 7 of the Bankruptcy Rules, which largely follow the Federal Rules of Civil Procedure
- Bankruptcy Rule 7001 provides an exclusive list of claims for relief that must be made by filing an adversary proceeding complaint. A party that fails to respond to a known request for relief in an adversary proceeding complaint can be in default



Contested Matters

- Any disputed matter that is not specifically listed in Bankruptcy Rule 7001 is a contested matter (Fed. R. Bankr. P. 9014(a)). A contested matter is typically commenced by filing a motion for relief, but can also be initiated by:
 - An application.
 - An objection to a motion or an application.
 - A response to a claim objection.
 - An objection to a plan or disclosure statement provision

What Is a Preference

- Transfers of a debtor's property made voluntarily or involuntarily by an insolvent debtor within 90 days of bankruptcy (or one year, if to an insider).
- Made on account of pre-existing debt and favor certain creditors over others.
- The good faith of the parties to the transfer is irrelevant.
- Section 547 of the Bankruptcy Code provides the debtor with the ability to set aside these transactions. It can then recapture the transferred property and bring it back into the bankruptcy estate, to be equitably distributed to all creditors
(§ 550(a)).

Purposes of Preference

- Discourages creditors from racing to dismember the debtor while it slides into bankruptcy.
- Facilitates the prime bankruptcy policy of equality of distribution among creditors of the debtor.



Elements of Preference

- Made to or for the benefit of a creditor (§ 547(b)(1)).
- Made on account of an antecedent debt (a debt that existed before the time of the transfer) (§ 547(b)(2)).
- Made while the debtor was insolvent (§ 547(b)(3)).
- Made within 90 days before the bankruptcy petition or within one year, if made to an insider (§ 547(b)(4)).
- Which enabled the creditor to receive more than it would have received in a Chapter 7 liquidation (§ 547(b)(5))

Defenses to a Preference Action

- Ordinary Course of Business (§ 547(c)(2))
- New Value (§ 547(c)(4))
- Contemporaneous Exchange (§ 547(c)(1))
- Creates a security interest in property acquired by debtor (§ 547(c)(3))



What is a Fraudulent Conveyance

- Transfers of a debtor's interest in property (or the incurring of an obligation) made voluntarily or involuntary within two years before a bankruptcy filing
- Section 548 of the Bankruptcy Code provides the debtor (or trustee) with the ability to avoid these transactions
- After avoidance, section 550(a) allows the debtor to recover the transferred property and return it to the bankruptcy estate to be equitably distributed to all creditors

Elements of a Fraudulent Conveyance

- Transfer of the debtor's property or interest in property (or obligation incurred by the debtor)
- The property was transferred or the obligation was incurred within two years immediately before a bankruptcy filing
- **"Actual" fraud** (§ 548(a)(1)(A)). Requires that the debtor acted with actual intent to defraud creditors
- **"Constructive" fraud theory** (§ 548(a)(1)(B)). Requires that the debtor received less than reasonably equivalent value for the property transferred and was insolvent at the time of, or rendered insolvent by, the transfer (intent does not matter)

Actual Fraudulent Conveyance

- Fraudulent conveyances can be avoided if made with an actual intent to delay, hinder, or defraud creditors (Section 548(a)(1)(A))
- Intent inferred from circumstantial evidence
- Courts consider certain "badges of fraud" as indicators of fraudulent intent. The presence of one badge can suggest fraudulent intent, but the presence of several can constitute strong evidence of an actual intent to defraud

Constructive Fraudulent Conveyance

- Received less than reasonably equivalent value for the transfer
(§ 548(a)(1)(B)(i))
- Was insolvent on the date of the transfer, or was rendered insolvent as a result of it (or was otherwise financially distressed)
(§ 548(a)(1)(B)(ii))
- Good faith of the parties to the transaction is irrelevant



Preference v. Fraudulent Conveyance

	Preference	Fraudulent Conveyance
Purpose	<ul style="list-style-type: none"> • Prevent favoritism to particular creditor and promote equality of distribution to creditors. • Prevent unfair payments on legitimate debts 	<ul style="list-style-type: none"> • Prevent wrongful reduction of the estate by transferring assets beyond creditors' reach • Protect the estate from "secret transfers"
Intent	<ul style="list-style-type: none"> • No fraudulent intent needed 	<ul style="list-style-type: none"> • Intent to defraud (actual or constructive)
Transferee	<ul style="list-style-type: none"> • Transfer must be to a creditor. 	<ul style="list-style-type: none"> • Transfer may be to anyone.

Preference v. Fraudulent Conveyance (continued)

	Preference	Fraudulent Conveyance
Insolvency	<ul style="list-style-type: none"> • 90-day presumption 	<ul style="list-style-type: none"> • No presumption
Payment of Antecedent Debt	<ul style="list-style-type: none"> • Required 	<ul style="list-style-type: none"> • Constitutes value
Reachback period	<ul style="list-style-type: none"> • 90 days (one year for insiders) 	<ul style="list-style-type: none"> • Two years
State law	<ul style="list-style-type: none"> • Bankruptcy concept • Few states have anti-preference statutes 	<ul style="list-style-type: none"> • UFCA • UFTA (or UVTA) • UCC bulk transfer laws • Common law

A photograph of a modern office building interior. The scene is captured from a low angle, looking up at a balcony. Two women are standing on the balcony, engaged in conversation. The balcony has a dark metal railing with a wooden handrail. The ceiling is white with several recessed circular lights. Large windows are visible on the left side of the frame, showing a bright, overcast sky. The overall color palette is cool, with blues and greys.

Key Issues in Upstream/Midstream Relationships in Bankruptcy



Can a Midstream Contract Survive the Bankruptcy of an Upstream Producer?

- How is the interest categorized?
 - Real property interest
 - Executory contract
- If the former, is the agreement a “covenant running with the land” such that it can’t be rejected by a successor?
 - Does it “touch and concern” the land?
 - Does it specifically bind the parties and their assigns?
 - Did the parties intend for it to “run with the land” (and what does that mean)?
 - Is the successor to the burden on notice?

In re Sabine Oil & Gas Corporation, 547 B.R. 66 (Bankr. S.D.N.Y. 2016). (“Sabine I”)

- The court concluded that it was precluded from making a final decision regarding whether the covenants at issue run with the land, but held that Sabine was authorized to reject the agreements, concluding that Sabine’s decision to reject such agreements was a reasonable exercise of the business judgment rule.
- Even though the court was unable to make a final determination on the covenant issue, Sabine I included the court’s “non-binding analysis” of whether the relevant covenants run with the land under Texas law and stated its “preliminary finding” that none of the covenants runs with the land either as a real covenant or an equitable servitude.

Sabine Oil & Gas Corporation v. HPIP Gonzales Holdings, LLC, (Bankr. S.D.N.Y. 2016). (“Sabine II”)

- In Sabine II, the court held that the Acreage Commitments did not constitute covenants running with the land as either real covenants or equitable servitudes under Texas law.
- At the core of the decision are the bankruptcy court’s conclusions that:
 - (i) the covenants in issue do not satisfy the “touch and concern” element under Texas law, and
 - (ii) assuming that horizontal privity of estate is a required element in Texas, horizontal privity is not present with respect to the agreements.

Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC, No. 19-03609, (Bankr. S.D. Tex. Dec. 20, 2019)

- In December 2019, the United States Bankruptcy Court for the Southern District of Texas entered a memorandum opinion and order finding that midstream gathering agreements created covenants running with the land under Oklahoma law that could not be rejected by bankrupt debtors.
 - This departs from the 2016 decision in *Sabine*, which held that a debtor could reject a midstream gathering agreement because it did not create a real covenant that ran with the land under Texas law.

Alta Mesa (continued)

- The court explained that a covenant touches and concerns the land when it “requires the performance of a physical act upon the land that directly benefits the landowner.”
 - The gathering agreements met that requirement because KFM used its surface easement to build a modern gathering system which enhanced the value of the leases.
 - Regarding the privity element, the Debtors’ leases granted them easements to develop hydrocarbons, and the Debtors granted a portion of those easements to KFM to provide gathering services.

Alta Mesa (continued)

- In holding that the easements directly burden the Debtors' interests, the court noted that, “[c]ontrary to the holding in *Sabine*, the surface easements directly affect the lessee’s underlying mineral interest” because “[w]ithout the surface easement, the lessee cannot capture reserve hydrocarbons.”
- Finally, based on the express language of the agreements, the parties intended the agreements to run with the land.

Takeaways

- While *Alta Mesa* does not outright reject the *Sabine* decision, it significantly challenges and limits its applicability.
- Furthermore, this split in authority underscores how important language choice can be in drafting gathering agreements.
- Whereas *Sabine* might have given upstream producers guidance on how to tailor gathering agreements in ways that would be beneficial during a potential bankruptcy, *Alta Mesa* provides some direction to midstream companies who wish to strengthen the argument that gas gathering agreements constitute covenants running with the land that cannot be rejected by an upstream operator in bankruptcy.

Disputed Issues Associated with Safe-Harbor Contracts



Bankruptcy Code Safe Harbors – Key Provisions

- Purpose: to protect against systemic risk and instability of financial markets
- The Code “safe harbor” provisions for covered contracts are exceptions to the automatic stay (Code §§ 365(e), 541(c)(1)): upon bankruptcy default, non-Debtor counterparty can enforce contractual rights to
 - Terminate, Liquidate or Accelerate
 - Code § 556 – Forward Contracts
 - Code § 560 – Swap Agreements
 - Code § 561 – Master Netting Agreement
- Foreclose on collateral: Realization on pledged collateral securing forward contracts, swap agreements is permitted and exempted from stay, assuming the non-Debtor party has properly perfected its security interests (Section 362(b)(6), (17), (27))
- Defense from preference and fraudulent transfer claims (Section 546(e), (g), (j))

Bankruptcy Code Safe Harbors – Public Policy

- Protect American financial markets from systemic risk and effects of a bankruptcy of major financial institution
 - Prevent debtor party from “playing the market” by assuming or rejecting a swap based on market moves post-filing
 - Prevent “cherry picking” of favorable swaps
 - Executory safe harbor contracts still subject to assumption or rejection if rights not exercised
- “Contractual rights” are broadly defined in the Code (more narrowly by courts), but the safe harbors do not provide independent rights
 - Bankruptcy courts tend to be unaccustomed to safe harbor provisions and may take a narrower view than expected
 - Efforts to legislatively eliminate or narrow safe harbors

Frequently Disputed Matters: Termination Value/Methodology

- Analyze the contractual valuation methodology carefully
 - Valuation issues and methodologies used (or not used) often is principal bone of contention with Debtor
 - Expect that the Debtor will have arrived at its own determination of “reasonable” valuation
 - Debtor may raise criticisms such as too few quotes, quotes not reasonable, market-makers knew if was for Debtor default, market too illiquid, failure to follow procedures accurately, etc.
 - Debtor may assert that termination was inappropriate which therefore constituted default so it is NDP
- Sometimes, various contracts will contain different methodologies (e.g., 1992 ISDA vs. 2002 ISDA vs. NAESB)
- Decisions to terminate based upon bankruptcy filing should be made promptly
 - Don’t wait too long before terminating; if you do, it could be too late
 - In re Amcor Funding Corp; In re Enron North America (MARTA); Metavante (In re Lehman Brothers Holdings, Inc.) (determining that riding the market was contrary to spirit of safe harbor provisions and that termination needs to be fairly contemporaneous to bankruptcy filing)
- Preparation is critical
- Preserve records and description of process

Industry-standard Master Agreements May Have Differing Methodologies: Crude Oil

LEAP

8. TERMINATION AND LIQUIDATION

8.2 ... The Performing Party shall calculate the Termination Payment by (a) valuing each Transaction at its Market Value as reasonably determined by the Performing Party as of the Early Termination Date and then determining the amount by which such then prevailing Market Value differs from the Contract Value For purposes of this Section 8.2, "Contract Value" and "Market Value" have the meanings specified below:

- (i) "Contract Value" means the amount of the Product remaining to be delivered or purchased under a Transaction multiplied by the Price specified in the Confirmation for the Transaction.
- (ii) "Market Value" means the amount of the Product remaining to be delivered or purchased under a Transaction multiplied by the market price for an equivalent transaction at the Delivery Location as determined by the Performing Party in a commercially reasonable manner. To ascertain the Market Value, the Performing Party may consider, among other valuations, quotations from leading dealers in swap contracts or physical trading markets, similar sales or purchases and any other bona fide third-party offers, all adjusted for the length of the term, relevant due date or delivery dates, volume and differences in transportation costs. A Party shall not be required to enter into a replacement transaction in order to determine the Market Value of a Transaction.

(3) Settlement Amount. With respect to each terminated Commodity Transaction, the Settlement Amount shall be equal to the contract quantity of crude oil, multiplied by the difference between the contract price per barrel specified in this Agreement (the "Contract Price") and the market price per barrel of crude oil on the date the Liquidating Party terminates this Agreement (the "Market Price"). If the Market Price exceeds the Contract Price in a Commodity Transaction, the selling party shall pay the Settlement Amount to the buying party. If the Market Price is less than the Contract Price in a Commodity Transaction, the buying party shall pay the Settlement Amount to the selling party. If the Market Price is equal to the Contract Price in a Commodity Transaction, no Settlement Amount shall be due. ...

(5) Market Price. Unless otherwise provided in this Agreement, the Market Price of crude oil sold or exchanged under this Agreement shall be the price for crude oil for the delivery month specified in this Agreement and at the delivery location that corresponds to the delivery location specified in this Agreement, as reported in Platt's Oilgram Price Report ("Platt's") for the date on which the Liquidating Party terminates this Agreement. If Platt's reports a range of prices for crude oil on that date, the Market Price shall be the arithmetic average of the high and low prices reported by Platt's. If Platt's does not report prices for the crude oil being sold under this Agreement, the Liquidating Party shall determine the Market Price of such crude oil in a commercially reasonable manner, unless otherwise provided in this Agreement.

Industry-standard Master Agreements May Have Differing Valuation Methodologies: ISDA Master Agreement

2002 ISDA

“Close-out Amount” means, with respect to each Terminated Transaction or each group of Terminated Transactions and a Determining Party, the amount of the losses or costs of the Determining Party that are or would be incurred under then prevailing circumstances (expressed as a positive number) or gains of the Determining Party that are or would be realized under then prevailing circumstances (expressed as a negative number) in replacing, or in providing for the Determining Party the economic equivalent of, (a) the material terms of that Terminated Transaction or group of Terminated Transactions, including the payments and deliveries by the parties under Section 2(a)(i) in respect of that Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date (assuming satisfaction of the conditions precedent in Section 2(a)(iii) and (b) the option rights of the parties in respect of that Terminated Transaction or group of Terminated Transactions.

Any Close-out Amount will be determined by the Determining Party (or its agent), which will act in good faith and use commercially reasonable procedures in order to produce a commercially reasonable result. The Determining Party may determine a Close-out Amount for any group of Terminated Transactions or any individual Terminated Transaction but, in the aggregate, for not less than all Terminated Transactions....

In determining a Close-out Amount, the Determining Party may consider any relevant information, including, without limitation, one or more of the following types of information: —

- (i) quotations (either firm or indicative) for replacement transactions supplied by one or more third parties that may take into account the creditworthiness of the Determining Party at the time the quotation is provided and the terms of any relevant documentation, including credit support documentation, between the Determining Party and the third party providing the quotation;
- (ii) information consisting of relevant market data in the relevant market supplied by one or more third parties including, without limitation, relevant rates, prices, yields, yield curves, volatilities, spreads, correlations or other relevant market data in the relevant market; or
- (iii) information of the types described in clause (i) or (ii) above from internal sources (including any of the Determining Party’s Affiliates) if that information is of the same type used by the Determining Party in the regular course of its business for the valuation of similar transactions.

The Determining Party will consider, taking into account the standards and procedures described in this definition, quotations pursuant to clause (i) above or relevant market data pursuant to clause (ii) above unless the Determining Party reasonably believes in good faith that such quotations or relevant market data are not readily available or would produce a result that would not satisfy those standards. ... Third parties supplying quotations pursuant to clause (i) above or market data pursuant to clause (ii) above may include, without limitation, dealers in the relevant markets, end-users of the relevant product, information vendors, brokers and other sources of market information. ...

Industry-standard Master Agreements May Have Differing Valuation Methodologies: ISDA Master Agreement (cont.)

1992 ISDA

"Market Quotation" means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market-makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party (taking into account any existing Credit Support Document with respect to the obligations of such party) and the quoting Reference Market-maker to enter into a transaction (the "Replacement Transaction") that would have the effect of preserving for such party the economic equivalent of any payment or delivery (whether the underlying obligation was absolute or contingent and assuming the satisfaction of each applicable condition precedent) by the parties under Section 2(a)(i) in respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. ...The Replacement Transaction would be subject to such documentation as such party and the Reference Market-maker may, in good faith, agree. The party making the determination (or its agent) will request each Reference Market-maker to provide its quotation to the extent reasonably practicable as of the same day and time (without regard to different time zones) on or as soon as reasonably practicable after the relevant Early Termination Date. The day and time as of which those quotations are to be obtained will be selected in good faith by the party obliged to make a determination under Section 6(e), and, if each party is so obliged, after consultation with the other. If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.

Industry-standard Master Agreements May Have Differing Valuation Methodologies: Additional items 1992 ISDA

"Loss" means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party's legal fees and out-of-pocket expenses referred to under Section 11. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

- First Method vs. Second Method

Disputes regarding Scope of Coverage of Safe Harbors

"The term "forward contract" means--

(A) a contract (other than a commodity contract, as defined in section 761) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of this title, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into...;

(B) any combination of agreements or transactions referred to in subparagraphs (A) and (C);...

(D) a master agreement that provides for an agreement or transaction referred to in subparagraph (A), (B), or (C), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a forward contract under this paragraph, except that such master agreement shall be considered to be a forward contract under this paragraph only with respect to each agreement or transaction under such master agreement that is referred to in subparagraph (A), (B), or (C); or

(E) any security agreement or arrangement, or other credit enhancement related to any agreement or transaction referred to in subparagraph (A), (B), (C), or (D), including any guarantee or reimbursement obligation by or to a forward contract merchant or financial participant in connection with any agreement or transaction referred to in any such subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562."

(11 USCS § 101)

The term swap agreement--

(A) is defined as--

(i) "any agreement, including the terms and conditions incorporated by reference in such agreement, which is--

(I) an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap;

(II) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement;

(III) a currency swap, option, future, or forward agreement;...

(VII) a commodity index or a commodity swap, option, future, or forward agreement;... [additional enumerated swap types]

(ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that--

(I) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference therein); and

(II) is a forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

(iii) any combination of agreements or transactions referred to in this subparagraph;...

(v) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), or (iv), together with all supplements to any such master agreement, and without regard to whether the master agreement contains an agreement or transaction that is not a swap agreement under this paragraph, except that the master agreement shall be considered to be a swap agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), (iii), or (iv); or

(vi) any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in clause (i) through (v), including any guarantee or reimbursement obligation by or to a swap participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 [11 USCS § 562];

Setoff Issues – A Refresher

- Section 553 of the Code allows counterparties of the debtor to exercise existing setoff rights if certain conditions are met:
 - Mutual, Bilateral Obligations
 - Pre vs. Pre and Post vs Post
- What makes it mutual?
 - Agreement by the parties does not create mutuality. (*SemCrude*)
 - Is it mutual as long it involves the same two parties? Not necessarily.
 - The claim and debt must be held in the same right.
- Principal vs. agent, trustee, etc.?
- Guarantors
- Do safe-harbor protections trump?
 - No. Despite broad language in Code, strict mutuality still required, and cross-affiliate setoff not allowed
- *SemCrude, Swedbank, UBS, American Home Mortgage Holdings, Arcapita*



Additional Contested Matters

- Technicalities matter
- Section 366 of the Code limits ability of “utilities” from discontinuing service or otherwise discriminating against a debtor based on pre-petition amounts owed, IF debtor provides “adequate assurance”
- What is a “utility”?
 - Forward contract merchants selling natural gas or electricity in competitive markets are sometimes included in motion
 - Undermines safe-harbor rights to terminate, accelerate and liquidate
 - Not a monopoly utility with service territory
 - Inconsistent with commodity sale model – e.g., specific transactions, quantities, term, etc.
- Common practice to file a motion seeking determination of what constitutes adequate assurance
 - Often get "interim orders" that set forth procedures for requesting adequate assurance and prohibition against discontinuing service while issues are negotiated and/or litigated
- Electricity – retail electricity status as a good vs service

Questions?



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