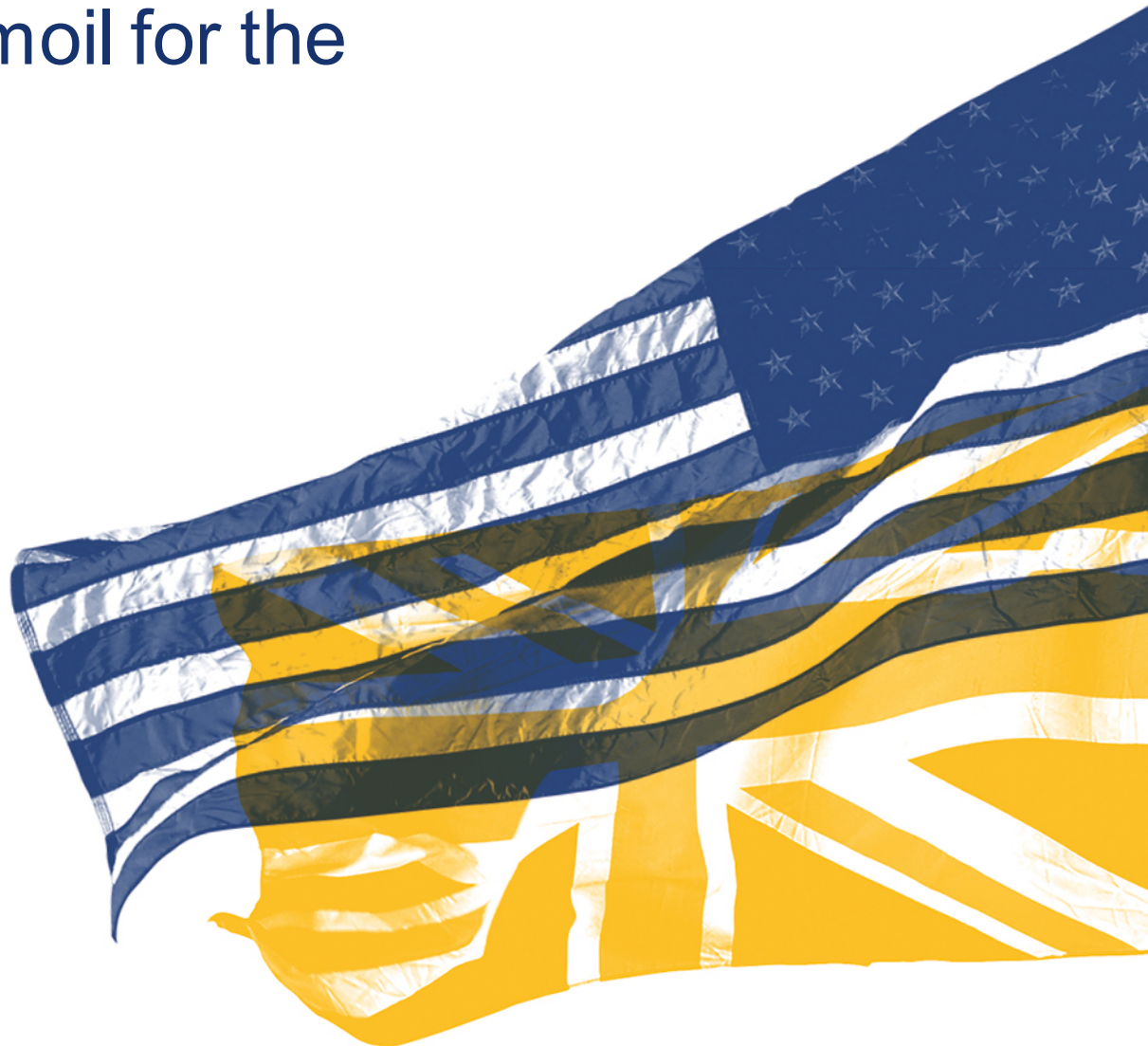


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In a Time of Turmoil for the Energy Markets

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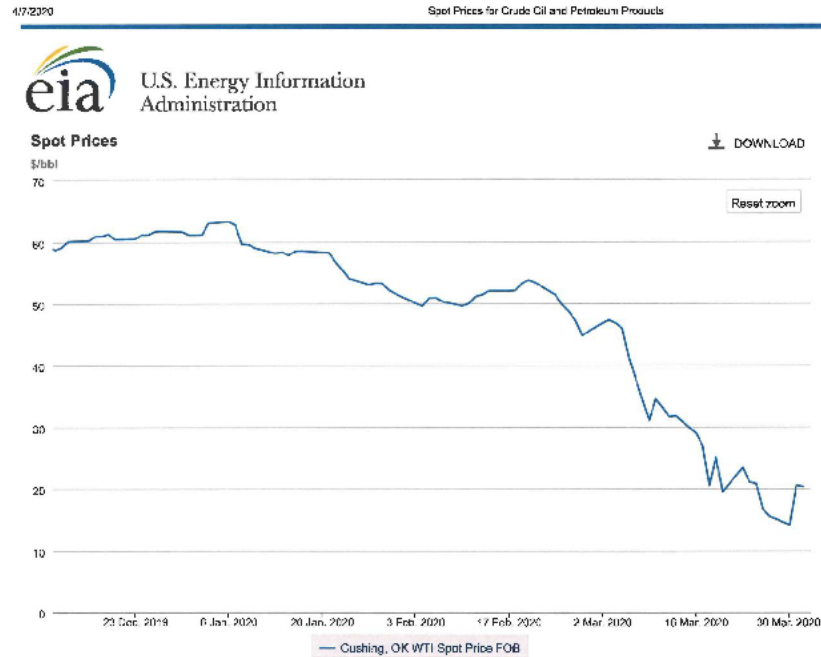
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Topics for Today

- The Industry in 2020: Where are we and how did we get here?
- Common Pitfalls in the Upstream Sector
- Reserve Based Lending in Energy Sector
- Warning Signs of Bankruptcy and Workout
- Credit Concerns My counterparty just filed! Now what?
- Contract Exposure
- Safe-Harbor Provisions (Forward Contracts, Swaps, etc.)

Where Are We And How Did We Get Here?

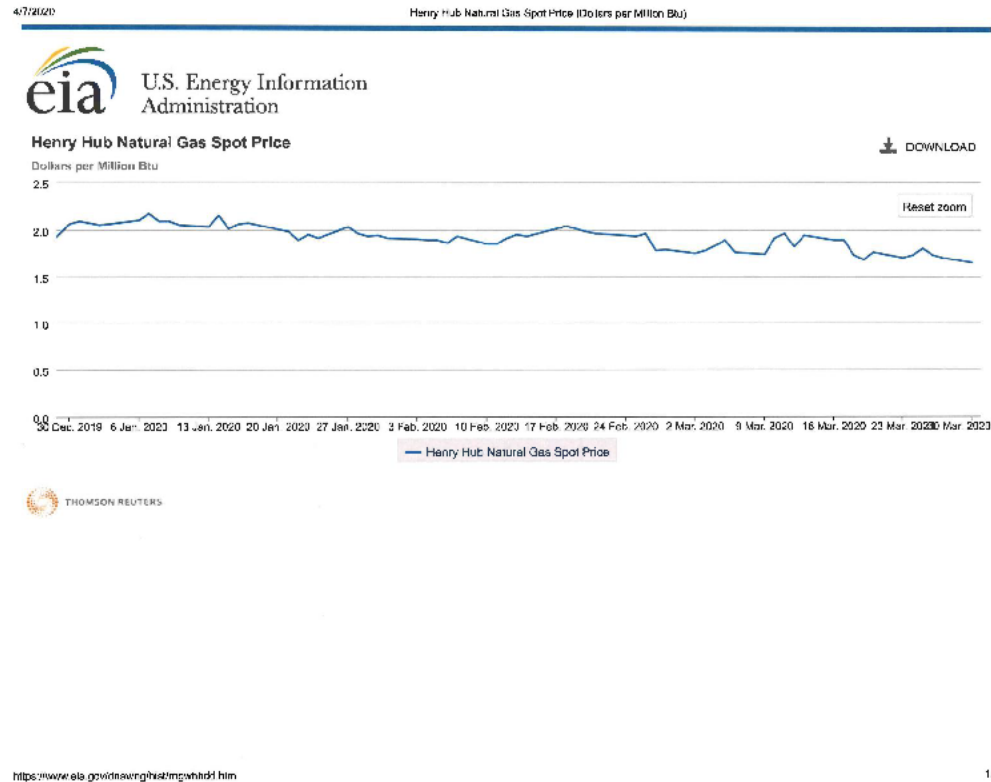


THOMSON REUTERS Source: U.S. Energy Information Administration

https://www.eia.gov/dnav/pet/pet_pri_spt_01_d.htm

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Where Are We And How Did We Get Here?



Market Turmoil and Industry Reaction

- Due to confluence of events, world demand for crude is down 30%
 - COVID-19
 - Failure to agree upon production cuts – Russia and Saudi Arabia
- Numerous E&P Companies have scaled back Cap Ex programs
- Ended stock buy-backs
- Some eliminating dividends
- Staff Reductions/Furloughs
- Many view the foregoing as only a start – could see numerous bankruptcies

Common Pitfalls in the Upstream Sector



Why Record?

- Recording laws are meant to protect good faith purchasers and creditors without notice of prior transfers from being injured or prejudiced by their lack of knowledge of the competing claim.
- An instrument that is properly recorded in the proper county is notice to all persons of the existence of the instrument.
- As a result, a subsequent purchaser or lienholder is bound by every recital, reference, and reservation contained in or fairly disclosed by an instrument which forms an essential link in the chain of title under which he or she claims.

What Must Be Recorded?

- Any instrument relating to real property.
- Remember powers of attorney and joint operating agreements.

What Can Be Recorded?

To be eligible for recording, the instrument must:

- Be in English or have attached thereto a correct English translation.
- Contain the mailing address of the grantee in the document or in a separate document signed by the grantor or grantee, or the requisite penalty must have been paid.
- Be signed by the grantor.
- Contain an acknowledgment, a sworn jurat or have been proved according to law.

Why Worry?

- An instrument that is ***properly recorded*** in the proper county is notice to all persons of the existence of the instrument.
- A conveyance of real property or an interest in real property or a mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice ***unless the instrument has been acknowledged, sworn to or proved and filed for record as required by law.***
- A document that is not properly acknowledged is not entitled to be recorded and, even if the county clerk records it, it will not constitute constructive notice to bona fide purchasers for value.

Sufficient Description of the Real Property Covered By the Instrument

- The legal description affords the means of identifying the real property.
- A property description is sufficient if the writing furnishes within itself, or by reference to some other existing writing the means or data by which the particular land to be conveyed may be identified with reasonable certainty.
- A conveyance in the chain of title that does not identify the land being conveyed is ineffective to pass title.
- A defective description of the property is one of the most frequent causes of title failure.

Where to Record?

- To be effectively recorded, an instrument relating to real property must be eligible for recording and must be recorded in the county in which a part of the property is located.
- If the document relates to a contiguous tract of land located in more than one county, recording of that instrument in only one of the counties is sufficient.

The Collateral

JOA Article VII.B:

Each party grants to the other parties hereto a lien upon ***any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area***, and a security interest and/or purchase money security interest in ***any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith***. ... Such lien and security interest ... ***shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.*** (Emphasis added.)

Texas oil and gas in the ground before it is reduced to possession is real property. Texas oil and gas, once produced and reduced to possession becomes personal property.



Perfection of Liens on Real Property

The provisions of the JOA and Recording Supplement *if left unchanged* will create a lien on real property that can be foreclosed through judicial proceedings.

Remember JOA Article VII.B:

Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith. ... **Such lien** and security interest ...

Foreclosure of a deed of trust does not require judicial proceedings, **but the JOA must be revised** to name a trustee and include the grant of the power of sale (if required by the property code of the relevant state).

Perfection of Security Interests in Personal Property

A security agreement is an agreement that creates or provides for a security interest. The provisions of the JOA and Recording Supplement *if left unchanged* will create a security interest in the Collateral that is enforceable under the UCC. Remember JOA Article VII.B.:

Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a ***security interest and/or purchase money security interest*** in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith. ... ***Such*** lien and ***security interest*** ...(Emphasis added.)

Default and Remedies

- Foreclose the liens granted on real property.
- Exercise the rights and remedies of a secured party under the UCC.
- Sue (at joint account expense) to collect the amounts in default, plus interest accruing on the amounts recovered.
- After a second written notice is sent to the defaulting party notifying it of the exercise of this option, suspend all of the rights of the defaulting party under the JOA until the default is cured.
- Delivery of a Notice of Non-Consent Election.
- Require advance payment from the defaulting party of such defaulting party's anticipated share of any item of expense for which Operator would be entitled to reimbursement under any provision of the JOA.



Reserve Based Lending



Reserve Based Lending

- Reserve Based Loans Overview (RBL)
 - Asset-based loan where amount available to borrow is based upon the value of, and is secured by specified oil & gas reserves, as determined periodically (Borrowing Base)
 - RBL repayment from proceeds of sales of recovered oil & gas or proceeds or other financings (e.g., corporate loans or second lien loans).
 - Usually not limited recourse and lenders can foreclose on unsecured / unencumbered assets of the borrower and/or oil & gas assets not included in the Borrowing Base upon default
 - Typically structured as revolving credit facilities to provide borrowers with flexibility to manage its operations and usually have a maturity of three to five years
- Borrowing Base Considerations in Oil & Gas RBL Facilities
 - Oil & Gas are depleting assets
 - Oil & Gas prices are volatile
 - Borrower has very little control over the value of its reserves
 - Lenders have significant discretion in determination of valuation oil & gas reserves and related Borrowing Base assumptions



Reserve Based Lending

- Borrowing Base
 - Reserve Reports by independent petroleum engineer / borrower
 - Lender review of reserve reports (usually by lender's independent petroleum engineer)
 - Analysis of assumptions, historical performance and findings relating to
 - well/oilfield locations
 - each wells production history
 - market prices for oil & gas
 - O&M costs of borrower's wells and related facilities
 - borrower's future cash flows
 - capital expenditures required to support operations
 - taxes
 - processing and transportation costs of recovered oil & gas
 - Risks: operating, regulatory/legal, exploration/drilling, reserve diversity



Reserve Based Lending

- Borrowing Base Redetermination
- Usually Semiannually (Spring/Fall)
- 2015/16 Redetermination Process
 - Significant Price Drop
 - Banks Overexposed to Sector
 - Tight Liquidity for Oil & Gas
- Anti-Hoarding Provisions
 - prevent borrowers from hoarding cash
 - to create negotiating leverage, or
 - in advance of a bankruptcy filing
 - Required prepay with excess cash
 - Prevent draw if cash in excess of limit

10 Year Crude Oil Price History



Source: <https://www.macrotrends.net/1369/crude-oil-price-history-chart>

Reserve Based Lending

2020 Borrowing Base Redeterminations

Borrowers

- Changes in ratios among Proved Developed Producing (PDP), Proved Developed Non-Producing (PDNP), and Proved Undeveloped (PUD) assets since prior redeterminations
- Ability to make required prepayments if Borrowing Base is reduced
- Ability to include additional oil & gas assets to cure any deficiency
- Ability to apply proceeds of permitted asset sales to mitigate any deficiency
- Availability of alternative sources of capital to prepay, cure or replace RBL
- Is bankruptcy a better choice for borrower than RBL's demands?

Lenders

- Significant Discretion
- Confidence in borrowers' ability to meet their RBL obligations is key
- Reduce Borrowing Base and also may
 - Require additional collateral
 - Limit ability to draw on RBL
 - Increase fees and interest
 - Tighten liquidity and other covenants
- More flexibility where borrower
 - Large and diversified operations
 - Hedged
 - Has other sources of capital available
- Is the bankruptcy of borrower better for lender than waivers and other accommodations?



Decline toward Bankruptcy



Warning Signs Of Bankruptcy Risk



-
- Debt issues
 - Upcoming principal or interest payment on bond debt
 - Upcoming maturity of bond debt
 - Imminent expiration of loan facility
 - Risk of upcoming bond default
 - Covenant breach/default on loan facility
 - Entry into forbearance agreement
 - Late/restated financials
 - Third party actions
 - Downgraded agency credit ratings
 - Loss of credit insurance
 - Loss of market for puts
 - Delisting notice from stock exchange
 - Distressed debt purchasers on the prowl
 - Notices from vendors or suppliers filing liens at well site under the applicable state mineral lien statute or law

Warning Signs Of Imminent Bankruptcy

- Sudden change of leadership (CFO, General Counsel or CEO)
- Sudden change in members of board of directors
- Retention of chief restructuring officer/ crisis manager
- Formation of ad hoc bondholder committee
- Retention of insolvency professionals
- Reports of negotiations with prospective chapter 11 lenders
- Bond default
- WARN Act



Pre-Bankruptcy/Workout Issues

- Pre-Negotiation Letters

- Key terms

- No oral modifications
- No agreement to forbear
- No waivers by Lender
- All discussions are inadmissible settlement discussions
- Acknowledgment of amounts owed
- Possible releases/waiver of defenses and counterclaims
- Should be signed by all Obligor
- Forbearance Agreements
 - Acknowledgments include existence of defaults, proper notice, debt and liens
 - Waiver of defenses and counterclaims by Obligor
 - Cross-defaulting and cross-collateralization of multiple facilities



Credit Concerns: My Counterparty May Go Bankrupt

- Once a supplier or customer files for bankruptcy, things get chaotic and some options are foreclosed
- Ideally, actions to take prior to bankruptcy filing:
 - Keep your ear to the ground
 - Monitor credit exposure and collateral closely
 - Monitor payments made and payment due dates
 - Collect payments due!
 - Gather executory contracts, transaction data, related documents
 - Evaluate whether to seek adequate assurances
 - Monitor potential contractual breaches prior to the bankruptcy
 - Generally advantageous to be out of the money to your counterparty, upon their bankruptcy

Counterparty Filing – Troubling Times



My Counterparty Filed! Now What? (Overview)

- Information gathering (including documents, if not already done)
- Evaluate deliveries, payments, collateral demands, collateral, guaranties, and status of letters of credit
- Obtain valuation reports for positions
- Assess types of contracts – safe-harbored? – and contractual rights; evaluate potential courses of action
- Analyze impact of “first-day motions”
- Assess termination and valuation issues and methodologies



Bankruptcy Code Chapter 11

- Provides for reorganization, rather than liquidation
- Section 1107 of the Bankruptcy Code places the “debtor in possession” in the position of a fiduciary
- The debtor (unless a "small business debtor") has the exclusive right to file a plan for reorganization for 120 days. This exclusivity period may be modified or expanded by the court.

Parties in a Chapter 11 Bankruptcy Case

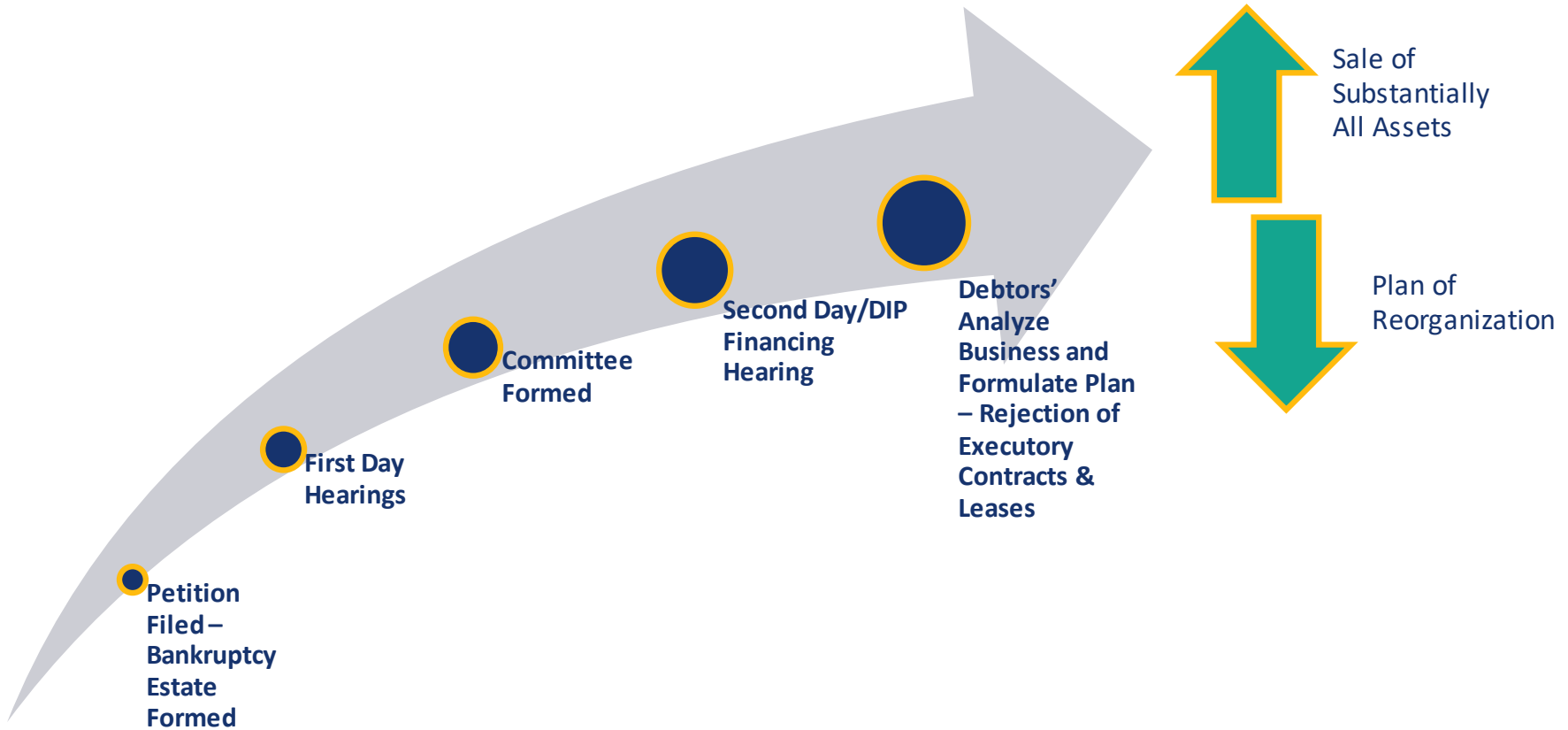
- Debtor
- Lenders
- Official Committee of Unsecured Creditors
- United States Trustee
- Unofficial or Ad Hoc Committees
- Contract/Lease Parties
- Creditors

Automatic Stay & Stay Relief Motions

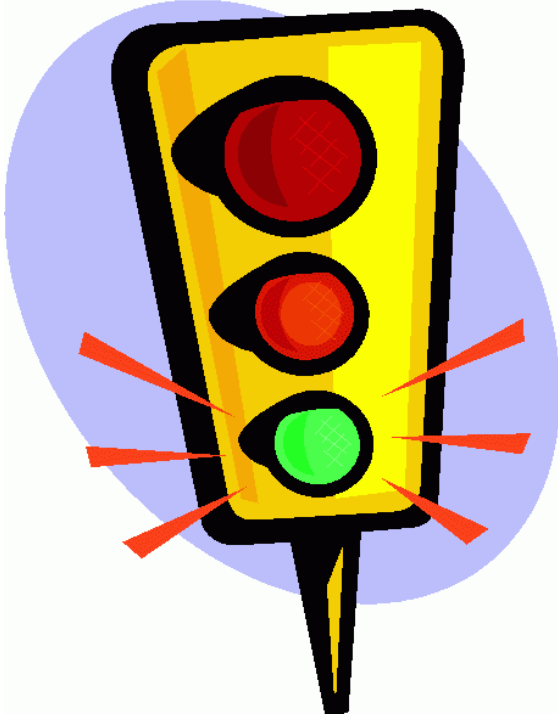
- Automatic stay initiated upon filing of the Bankruptcy Case
- Restricts creditors from:
 - Continuing prepetition litigation
 - Collecting a debt
- Motions for relief are granted with a finding of cause (rare)
- Does not prevent motion to compel assumption or rejection



The Bankruptcy Process (Chapter 11) - Overview



Proofs of Claim



- Due date and filing procedures
- Secured claims
- Priority claims
- Administrative expense claims
- General unsecured claims
- Payment of certain prepetition claims



Executory Contracts in Bankruptcy

- Bankruptcy Code section 365 deals with “executory contracts” and “unexpired leases”
- “Executory Contract” not defined by the Bankruptcy Code
- Section 365 allows a debtor to:
 - assume (cure required)
 - assume and assign (cure required)
 - reject (treated as a pre-bankruptcy breach)
- Preserves a valuable property right for debtors
- Allows debtors to shed unfavorable obligations

The Bankruptcy Process (Cont'd)



Critical Vendor Orders

- Debtor seeks authority to pay the pre-petition claims of certain vendors deemed essential to its operations.
- Important considerations:
 - Payment timeline
 - Terms of payment
 - Requirements to waive claims or credit terms

Safe-Harbor Contracts



Bankruptcy Code Safe Harbors – Key Provisions

- The “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 – Commodities or Forward Contracts
 - Code § 559 – Repurchase Agreements
 - Code § 560 – Swap Agreements
 - Code § 561 – Master Netting Agreements
 - Off-set or net termination values/payment amounts, for covered contracts, MNAs
 - Foreclose on collateral: Realization on pledged collateral securing swap agreements is permitted and exempted from stay, assuming the non-Debtor party has properly perfected its security interests
 - Defenses to avoidance: protection from preference/fraudulent transfer claims

Assessment of Contracts and Exposure

- To determine your options, need to consider:
 - Are the contracts at issue safe-harbor contracts?
 - Forward contracts (commodity), swap agreements, repos, securities agreements, futures, master netting agreements
 - Are physical deliveries en route?
 - Do I have product stored at debtor's facility?
 - What is the contractual exposure – AR, AP, collateral and forward exposure? Setoff rights?
 - Has a breach occurred and can I or should I terminate?
 - Do I want to continue to do business with the debtor during bankruptcy?
- Are my choices limited by one of the first-day motions?

Termination And Valuation Of Safe Harbored Contracts

- If decision is made to terminate:
 - Analyze the contractual valuation methodology carefully
 - Sometimes, various contracts will contain different methodologies (e.g., 1992 ISDA vs. 2002 ISDA vs. NAESB), or fall under an MN
 - Follow the contractual methodologies (whether you have a claim or owe an early termination payment)
 - Document and retain support for the methodology used and steps followed; it may be important in negotiations with debtors
 - Don't wait too long before terminating; if you do, it could be too late
 - Follow contractual notice provisions strictly!

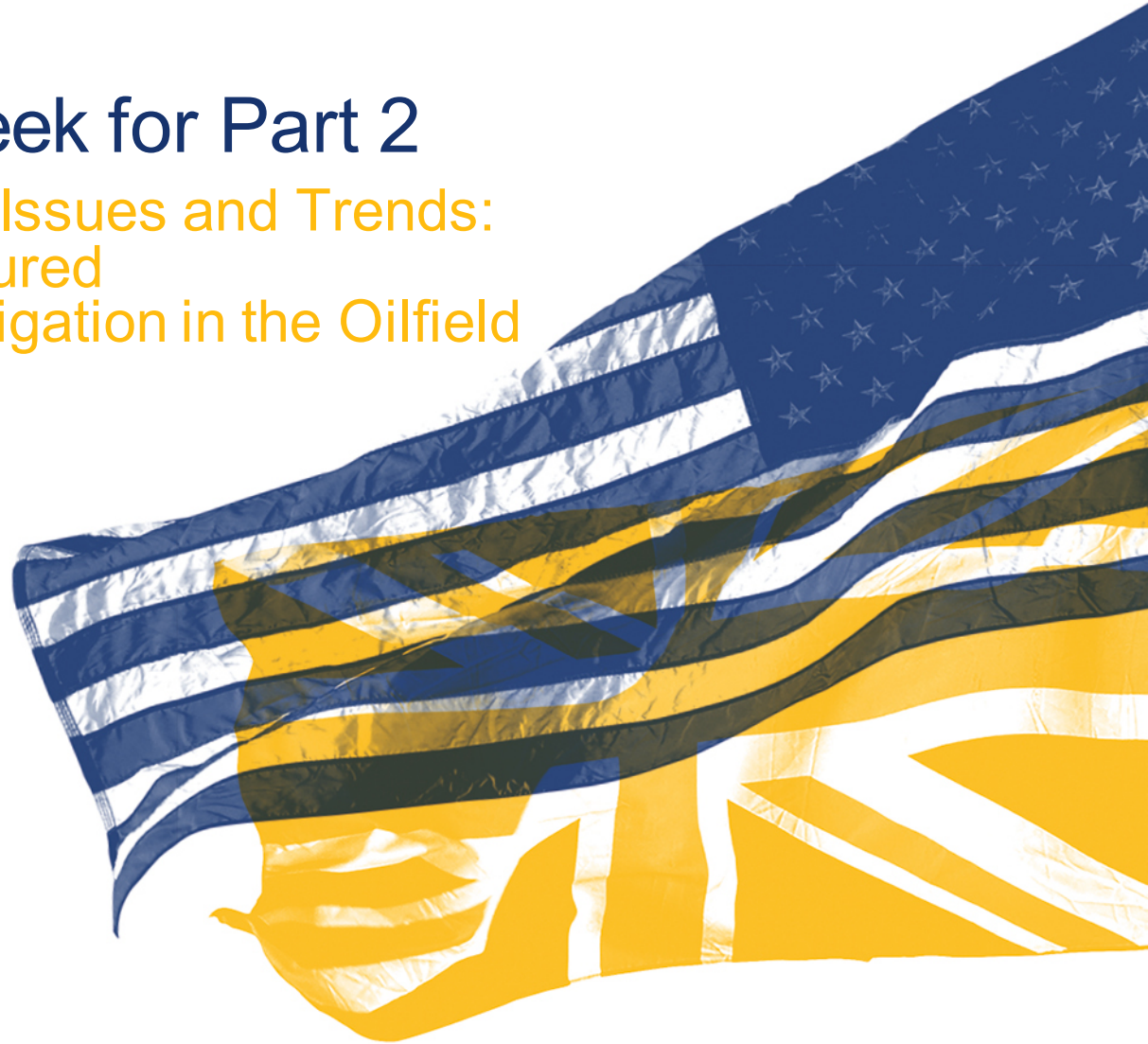
Questions?

Join Us Next Week for Part 2

Bankruptcy Litigation Issues and Trends: Issues Facing Unsecured Creditors/Contract Litigation in the Oilfield

April 15, 2020
11:00 a.m. CST

Paul Turner
Tony Guerino
Liz Klingensmith
Kevin Mangan





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