

OPPORTUNITY KNOCKS: PURCHASING PROPERTY THROUGH BANKRUPTCY SALES



AKERS & THOMPSON LLC

Serving the Rocky Mountain
Oil and Gas Industry for over 30 Years

Akers & Thompson LLC

ATTORNEYS AND COUNSELORS AT LAW

GOALS FOR PRESENTATION

- A. Basic understanding of types of Bankruptcy filings
- B. Treatment of Oil and Gas Properties and Contracts
- C. Purchasing from the Bankruptcy Estate

WHAT IS NOT COVERED (AMONG OTHER ISSUES)

1. Debtor's Bankruptcy Planning
2. Creditor's rights
3. Litigation techniques
4. Discussion of jurisdiction/state specific laws
5. Case law review

WHY THIS TOPIC?

Estimated that one-third of all American oil producers are at a “high risk” of filing bankruptcy

-Deloitte Consulting LLP

ROADMAP OF PRESENTATION

- I. Different types of bankruptcy filings
- II. Chapter 11 Filings – “Reorganization”
bankruptcy
- III. How oil and gas properties are treated in
bankruptcy
- IV. Procedures to Buy/Sell assets in bankruptcy
- V. Benefits/Pitfalls

I. TYPES OF BANKRUPTCY FILINGS

1)Chapter 7

2)Chapter 11

3)Chapter 12

4)Chapter 13

GOALS OF ANY FILING

1. No debtor's prisons in United States
2. Creates automatic stay
3. "Second chance" for Debtor
 - a. Fresh Start, Re-organize Debt
4. Increase payments to creditors
 - a. Both Secured and Unsecured
 - b. Maximize the estate
5. But remember, it is a benefit to Debtor, so they have to jump through hoops, and it must be supervised by Court/Trustee

U.S. TRUSTEE VERSUS BANKRUPTCY TRUSTEE

U.S. Trustee

- Department of Justice
- Oversees administration of bankruptcy cases
- Behind the scenes
- Fraud/criminal charges

Trustee in Bankruptcy

- Local attorney or non-attorney
- Can assume control of property in bankruptcy estate
- Assists in administration of bankruptcy case

CHAPTER 7 BANKRUPTCY FILINGS

- “Liquidation” – both business and individuals
- Most businesses do not file chapter 7
- Rather reorganize debts in Chapter 11
 - Taxes, litigation strategies
- No repayment plan for an individual

CHAPTER 7 BANKRUPTCY FILINGS (CONTD.)

- Trustee is appointed
- Grounds to deny Chapter 7 filers
 - Special mechanism – lets “good” debtor walk away
- Means-test for individuals
- Unlike individual, companies don’t survive a Chapter 7 filing
 - Lose ability to operate/control
 - Trustee’s control

CHAPTER 12 BANKRUPTCY FILINGS

Family Farmer/Family Fisherman

1. Must have “regular” income
2. Parallels Chapter 13 – Individuals with “regular” income
 - Tailored to the lack of consistent income and high levels of debt
3. Unique economic realities of family farmers and the family fisherman
4. Debtor must file a plan to repay debts (3 to 5 years)
5. Trustee appointed

CHAPTER 13 BANKRUPTCY FILINGS

“Adjustment of Debts of an Individual with Regular Income”

1. Plan (3 to 5 years)

2. Why not file Chapter 7?

- Chapter 13 requires re-payment plan

3. Individuals that don't qualify for Chapter 7

- Yes, you have to have a repayment plan

CHAPTER 13 BANKRUPTCY FILINGS (CONTD.)

1. Unlike Chapter 7, Debtor in Chapter 13 usually keeps possession of its property
2. Trade off, debt is not “discharged” like in Chapter 7
3. Individual can keep some of its valuable assets

CHAPTER 13 BANKRUPTCY FILINGS (CONTD.)

1. Debtor must still make all mortgage payments during the Chapter 13 plan
2. Advantage allows Debtor to reschedule secured debts
 1. Not mortgage on primary residence
3. Extend debts for duration of Chapter 13 plan – could lower monthly payments

CHAPTER 11 BANKRUPTCY FILINGS

“Reorganization”

1. Usually a corporation, but not always
2. Debtor must file a plan of reorganization
3. Debtor-in-Possession
 - Generally gets to keep possession assets
4. U.S. Trustee supervises case

CHAPTER 11 BANKRUPTCY FILINGS (CONTD.)

Goal of Chapter 11 –

- Reorganize debt of Debtor, or orderly liquidation
- Allow Debtor to continue operations
- Repayment to Creditors

To meet that goal –

- Debtor allowed to terminate burdensome contracts and leases
 - See Executory contracts
- Re-obtain assets
- Recalibrate operations

Allows (hopefully) Debtor to become profitable once again

CHAPTER 11 BANKRUPTCY FILINGS (CONTD.)

Debtor jumps through hoops in order to consolidate and emerge with reduced debt and a reorganized business

- Belief that Creditors will receive more from Chapter 11 reorganization than Chapter 7 liquidation

CHAPTER 7 VERSUS CHAPTER 11

Chapter 7: liquidate all (or most) assets

- **Trustee in charge**

Chapter 11: Debtor can retain possession

- **Of those assets to be sold, raise cash for creditors or ongoing operations**

II. CHAPTER 11

Most likely filing of E&P, Non-operators, Midstream, etc.

Most filings have been Chapter 11

- Endeavour Operating Corporation
- Quicksilver Resources Inc.
- Sabine Oil & Gas Corp.
- Samson Resources Corp.
- Peabody Energy Corp.

SOME PARTIES IN TYPICAL CHAPTER 11

Debtor-in-Possession

U. S. Trustee

Secured Creditors

Creditors' Committee

Court

Examiner (rare)

DEBTOR-IN-POSSESSION

A debtor-in-possession (DIP) –

Corporation or Individual that filed for protection under Chapter 11 of the bankruptcy code, and while in bankruptcy, remains in control of property that Creditors have liens against, and/or preserves ability to operate its business.

DEBTOR-IN-POSSESSION

Why would Debtor prefer DIP status?

- **Know business/assets better than Trustee**
 - Wind-up business
 - Emerge from Bankruptcy
- **Pre-arranged sale (See Stalking Horse)**
- **More flexibility**
 - Can use, sell or lease if in ordinary course (generally)
 - But must act in best interest of Creditors

US TRUSTEES ROLE IN CHAPTER 11

- Supervises Administration
- Monitors compensation plans, reimbursement to professionals
- Ensures accuracy of disclosures
- Promotes efficiency and timeliness

SECURED CREDITORS/CREDITORS' COMMITTEE

Secured Creditors – have perfected lien against Debtor's property. In line to be paid before unsecured creditors. More rights than unsecured creditors.

Creditors' Committee – Appointed by U. S. Trustee, made up of largest unsecured creditors, with the task of representing all unsecured creditors. Can object to, or submit their own plan of reorganization. Power to investigate Debtor's assets/liabilities.

SPECIFICS OF CHAPTER 11 BANKRUPTCY PROCEEDING

- **Filing Date**
 - Creates Automatic Stay
 - Creates the Estate

AUTOMATIC STAY

- 1. Paramount piece of bankruptcy**
- 2. Gives debtor the ability to hit pause button**
- 3. Collection efforts of creditors stopped**

BANKRUPTCY ESTATE

1. All property subject to bankruptcy

- Legal and equitable property of Debtor

2. Can even include money payments and assets divested immediately prior to filing (Lookback period)

- Can also include cancelling newly entered contracts
- Generally 90 days or 1 year (Look back)

LOOKBACK PERIOD/PREFERENTIAL TRANSFERS

- Power to avoid transfers made in 90 days prior to filing
- Up to 1 year for transfers made to “insiders”
 - General partners, directors, officers, relatives

EXECUTORY CONTRACTS

Under Bankruptcy code, Debtors and Trustees can assume or reject executory contracts or unexpired leases.

Not defined in the code

- Contract of Debtor where “the obligations of both the bankruptcy and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.”

- *N.L.R.B. v. Bildisco & Bildisco*, 456 US 513 (1984).

EXECUTORY CONTRACTS

Remember Goal of Bankruptcy :

- Increase amount received by creditors, maximize money for the estate, so shed undesirable executory contracts to increase value of assets to be sold, or assets to survive the bankruptcy.

In re Sabine Oil & Gas Corp.

EXECUTORY CONTRACTS

Business decision to assume or reject. Court will generally not get involved.

III. OIL AND GAS IN BANKRUPTCY

1. Oil, Gas, Mineral Leases

2. Contracts

- JOA, AMI, Processing, Master Service, Transportation, etc.

3. Miscellaneous

ARE OIL AND GAS LEASES EXECUTORY CONTRACTS?

Split jurisdictions.

Depends how a mineral lease is defined.

- State law will determine
- Most jurisdictions – “fee simple determinable in minerals”
- Minority – profit-à-prendre (right of taking)

EXECUTORY CONTRACTS/OTHER ISSUES

In re: Sabine Oil & Gas Corporation

- Must determine whether BOTH parties have performance remaining

At risk

- JOA, Gas purchase contracts, AMI, Farmouts, etc.

Court can split the baby

EXECUTORY CONTRACTS/OTHER ISSUES

Goal: Get rid of executory contracts when it would result in increased value of Debtor's property

IV. PURCHASING ASSETS IN BANKRUPTCY

- 1. Generalities/Sample sales process**
- 2. Stalking Horse/Bidders**
- 3. Due Diligence**
- 4. Market/Resources**

GENERALITIES OF PURCHASING FROM BANKRUPTCY ESTATE



SELLING DEBTOR-IN-POSSESSION

- 1) Probably have an outline of a sale before filing
 - Value in mind
 - Stalking Horse might already be in place
 - Due diligence, evaluation, financing/cash
- 2) Cherry picking which contracts to assume or reject
- 3) Hired company to shop pre-filing

STALKING HORSE BIDDER

- What it is – first bidder
- Due diligence up front
- Already selected contracts to reject/assume
- Break-up fee (3%)
- Bidding procedures
- Different types of Stalking Horses

STALKING HORSE BIDDERS

- **Stalking Horse “specialists” (Sell company with better contracts)**
 - Build profit into the bid
 - EBIDA – Earnings before interest, depreciation and amortization
 - EBITDA – Earnings before interest, taxes, depreciation and amortization
- **Liquidation buyers**
- **Ongoing business purchasers**
 - New management, flip business in short/mid-term
- **Take-over purchasers**
 - Step in shoes of Debtor to run business
 - Incorporate portfolio into their own

PURPOSE OF STALKING HORSE BID

- Sets market
- Determines contracts to be assumed/rejected (typically)
- DIP/Trustee can use opening bid to set up auction, subsequent bids

SAMPLE PROCESS

- 1) Order Approving Bidding Procedures**
- 2) Notice of Auction**
- 3) Hearing for approval of sale of Debtor's assets**
- 4) Procedures for Assignment**
- 5) Assignment Notice**
- 6) Result of Auction Notice**
- 7) Notification to Creditors**

ORDER APPROVING BIDDING PROCEDURES

1. Sets bidding requirement, and how bids will be submitted
2. Ensures procedures were negotiated in good faith
3. Identifies Stalking Horse
4. “Break-up” fee
5. Sets out imperative dates
6. Defines Qualified/Acceptable Bidders

ORDER APPROVING BIDDING PROCEDURES

7. Sets Bid increments

8. Auction Procedures

9. Location of Auction

10. What contracts will be assumed or rejected

NOTICE OF AUCTION

Filed with the Bankruptcy Court

- Remember goal
 - Need to notify all interested parties
 - Certain parties have a right to object

PROCEDURES FOR ASSIGNMENT/ASSIGNMENT NOTICE

Filed with the Bankruptcy Court

- Court/Trustee must protect creditors' interests

RESULT OF AUCTION NOTICE

- **Must ensure the approved procedures were followed**
- **Successful bidder identified**
- **Purchase price**
- **Identifies Backup Bidder**
- **Allows for objection from interested party**

NOTIFICATION TO CREDITORS

- Additional opportunity for Creditors to object
- Remember goal

APPROVAL OF SALE OF DEBTOR'S ASSETS

- After approvals and lack of objections
- Finality
- No going back

ASSETS FOR SALE: WHERE TO LOOK

- Docket
 - PACER (<https://www.pacer.gov/>)
 - Chapter 11- Debtor's Counsel
 - Chapter 7 – Trustee
- *Contact Trustees. Call them/write them.**

WHERE TO LOOK (CONTD.)

- **Online**
 - <http://www.bkassets.com/>
 - <http://www.nabt.com/>
 - <http://www.marketassetsforsale.com/>
 - <https://www.inforuptcy.com/marketplace>
- **Investment bankers/brokers**
 - <http://www.ssgca.com/>

SUBSEQUENT BIDDER/PURCHASER

1. Learn of assets for sale
 - Internal valuation
2. Review Stalking Horse bid
3. Review Bid Packet and other provided records
4. Warrant taking next step?

DUE DILIGENCE

1. What is normally provided by Trustee or Debtor:

1. Bid packet
2. On hand records
3. Data room

2. Buyer is on their own to conduct due diligence

3. Typically buy “as-is”.

If you have to change offer after it has been noticed, you have to re-notify everyone

DUE DILIGENCE

Word of Caution

- **Must identify executory contracts to be rejected**
- **Sold without warranty**
- **What's done is done**

V. BENEFITS AND DRAWBACKS

Some Bankrupt Oil and Gas Drillers Can't Give Their Assets Away, January 19, 2016

<http://www.bloomberg.com/news/articles/2016-01-20/some-bankrupt-oil-and-gas-drillers-can-t-give-their-assets-away>

- 2014 Terry Clark (White Marlin Oil & Gas Co.) made an offer to buy properties from Dune Energy Inc.
- 2015, Dune filed for bankruptcy
- White Marlin Oil & Gas Co. purchased the assets at a deep discount in auction

“What we offered versus what we got it for, it’s a great price,” [Terry] Clark said. “We’re going to continue to play these bankruptcies. We’re participating in two more right now.”

BENEFITS

- Below market value
- Free from some burdens and executory contracts
- Select to assume beneficial contracts
- Cleanse assets – free and clear of encumbrances (those negotiated)

POTENTIAL DRAWBACKS

- **Lack of information/records**
 - Unreliable
- **Difficult financing/Can require cash**
- **Debtor not able to help finance typically**
- **Limited time to conduct due diligence review**

POTENTIAL DRAWBACKS

- **As-is, no warranty, no recourse**
- **Some burdens/obligations survive**
- **Lots of parties involved, unlike PSA**
 - Secured Creditors, Unsecured Creditor's Committee, Equity Committee, US Trustee's Office, Bankruptcy Court, Debtor, Debtor's Counsel
- **Ongoing objections**

CONCLUSION

- *Unique opportunity*
- *Different world*
- *Many formalities*
- *Several parties*

TAKE-AWAY

Get assistance from a qualified bankruptcy professional...



THANKS AND QUESTIONS

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