

Vinson & Elkins

FEBRUARY 2016

KEY CONSIDERATIONS IN DISTRESSED UPSTREAM M&A

Energy Series

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TODAY'S PANEL



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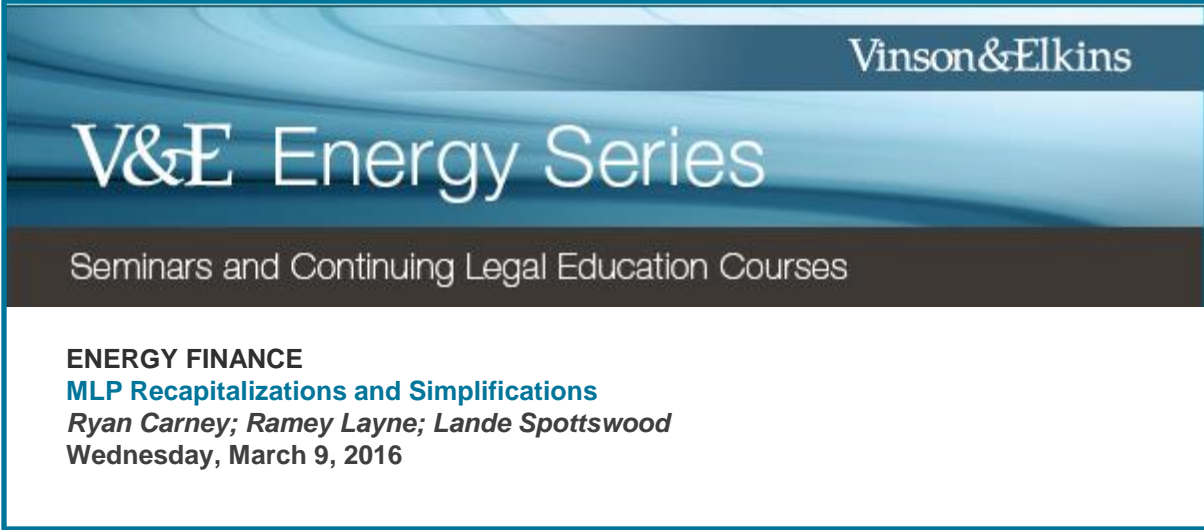


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SAVE THE DATE



Vinson & Elkins

V&E Energy Series

Seminars and Continuing Legal Education Courses

ENERGY FINANCE
MLP Recapitalizations and Simplifications
Ryan Carney; Ramey Layne; Lande Spottswood
Wednesday, March 9, 2016

DISCUSSION TOPICS

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Industry Headwinds

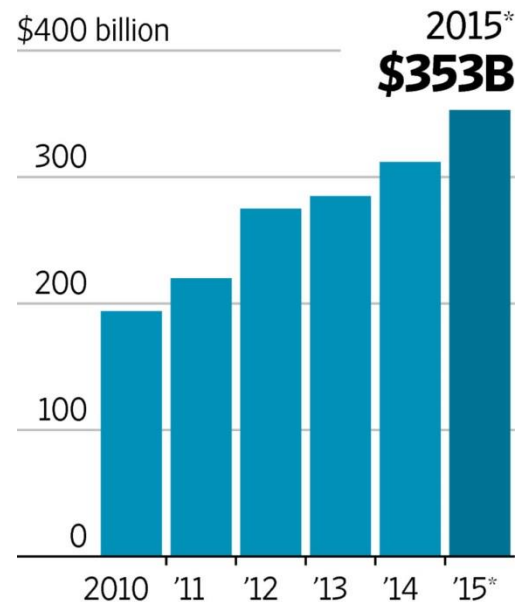
INDUSTRY HEADWINDS

- Approximately \$353 billion of Long Term Debt outstanding
- 30+ E&P Companies have already filed for bankruptcy since January 1, 2015

Source: *The Wall Street Journal*

Mounting Debt

Long-term debt for oil exploration and production companies in the U.S. and Canada



*Through Dec. 17

Note: Based on 134 public companies

Source: AlixPartners

THE WALL STREET JOURNAL.

INDUSTRY HEADWINDS (CONT'D)

- Expiring Hedges. According to Raymond James:
 - As of January 2015, 30% of U.S. E&P volumes were hedged
 - As of January 2016, 15% of U.S. E&P volumes are hedged
 - Expected to drop to 5% in 2017
- Low Hedge Volume. According to IHS:
 - Large U.S. E&P companies have hedged 6% of oil production at \$53.85 per barrel and 16% of gas at \$3.58 per MCF for 2016
 - Mid-sized U.S. E&P companies have hedged 43% of oil production at \$60.54 per barrel and 26% of gas production at \$3.34 per MCF for 2016
- U.S. Regulators are currently in the process of reviewing oil and gas loan portfolios and are expected to classify more loans as high risk

CERTAIN SELECTED BANKRUPTCY FILINGS IN 2015

- 2015 Oil & Gas Bankruptcies covered almost \$18 billion in debt
(Source: *Oil & Gas 360*)

Select Oil and Gas Bankruptcy Filings of 2015			
Filing Date	Debtor	Filing Date	Debtor
12/31/2015	Swift Energy Co.	7/15/2015	Sabine Oil & Gas
12/17/2015	New Gulf Resources	7/15/2015	Milagro Oil & Gas
12/15/2015	Magnum Hunter Resources	6/18/2015	Saratoga Resources
12/14/2015	Cubic Energy	5/15/2015	Duer Wagner Oil & Gas
12/8/2015	TransCoastal Corp.	5/8/2015	American Eagle Energy
12/7/2015	Energy & Exploration Partners	4/30/2015	ERG Resources
11/9/2015	Parallel Energy	3/30/2015	Lamina Energy
10/26/2015	RAAM Global Energy Company	3/17/2015	Quicksilver Resources
10/1/2015	Miller Energy Resources	3/10/2015	Victory Exploration
9/16/2015	Samson Resources	3/9/2015	BPZ Resources
8/11/2015	Black Elk Energy Offshore	3/8/2015	Dune Energy



Out-of-Court Acquisitions from Distressed Sellers

OUT-OF-COURT ACQUISITIONS FROM DISTRESSED SELLERS (PRE-BANKRUPTCY)

- Benefits
 - Faster than bankruptcy sales
 - Parties directly negotiate closing risk (conditions to closing) and terms of definitive documents
 - Customary allocation of liabilities and pre- and post-effective time expenses
 - General diligence period and adjustment for title and environmental defects, casualty losses, etc.
 - No court approval required
- Risks/Downside
 - Fraudulent Transfer Risks / Avoidable Preferences
 - Acquisition is not “free and clear” of existing liens, claims and encumbrances
 - PSA Considerations
 - If seller files for bankruptcy after signing but before closing, Buyer may be stuck with a “hanging” PSA that Seller can reject as an executory contract
 - If seller files for bankruptcy after closing, Buyer may be left with unenforceable indemnities and no post-closing recourse; prepetition unsecured claims against debtor seller
 - Must comply with anti-assignment provisions, consent rights and rights of first refusal

AVOIDANCE OF TRANSACTIONS -- FRAUDULENT TRANSFER

- Pre-bankruptcy transactions may be avoided as a “fraudulent transfer” or “fraudulent conveyance”
- Federal and State Look-Back Period
 - Federal look-back period: 2 years
 - State look-back period: usually longer (TX: 4 years)
- If transaction is determined to be a fraudulent transfer:
 - Trustee has the power to (1) recover assets from the Buyer or (2) recover the full value of the assets from the Buyer (e.g., the value of the assets at the time of transfer less than what was actually paid)
 - Remedies of Buyer
 - “Good faith” Buyers are entitled to a lien on the assets to secure the value of any improvements made by the Buyer after the initial closing
 - If Debtor in possession or Trustee recovers the assets, Buyer has a claim for damages/recovery of purchase price – typically a general unsecured claim
 - If PSA has not closed, Buyer can seek return of deposit
 - Note: Even though assets may be returned to the Debtor in possession or Trustee, Buyer may remain liable for unavoidable obligations (such as plugging and abandonment, credit support, environmental obligations, etc.) by virtue of closing the avoided transaction and/or entering the chain of title

AVOIDANCE OF TRANSACTIONS -- FRAUDULENT TRANSFER (CONT'D)

- Actual Fraud: Transfers “*with actual intent to hinder, delay, or defraud*” a creditor
- Constructive Fraud: Debtor received less than a “*reasonably equivalent value*” and debtor:
 - was insolvent at the time, or as a result of, the transfer;
 - made the transfer, or incurred such obligation, to or for the benefit of an insider, under an employment contract and not in the ordinary course of business;
 - was engaged, or was about to engage, in business or a transaction for which any property remaining with debtor was “unreasonably small capital” (this prong is applicable in TX but not other states); or
 - intended to, or believed that debtor would, incur debts that would be beyond debtor’s ability to pay such debts as they mature (this prong is applicable in TX but not other states).
- Defense to Constructive Fraud: Transferee acted in “good faith” and the transfer was “for reasonably equivalent value”

KEY TAKEAWAYS

- Assess creditworthiness of the Seller
- Analyze fraudulent conveyance risks
 - Document scope of marketing / sales process
 - Consider obtaining third party solvency, valuation and/or fairness opinions
 - Document valuation methodology and price negotiations
- Key PSA considerations:
 - No deposit or deposit in third party escrow account
 - Hold backs, escrows, parent guaranties or other credit support for indemnities and PSA obligations
 - First priority liens on seller's assets (applicable to JV transactions)
 - Draft to guard against seller's ability to reject or accept specific agreements (e.g., include key provisions all in one agreement)



Issues Related to Certain Midstream and Upstream Contracts

RECENTLY PUBLISHED ARTICLES

GATHERING AND PROCESSING AGREEMENTS – BANKRUPTCY “REJECTION” RISK

V&E Energy Restructuring and Reorganization Updates E-communication, February 10, 2016

Recent bankruptcy cases (e.g., Sabine Oil and Gas, Quicksilver Resources) have raised issues regarding the viability of midstream gathering and processing agreements (GPAs) with upstream producers.

Generally, these cases have involved motions to “reject” the GPAs so that the upstream producer is excused from performance. While no rulings have yet been made, the bankruptcy judge in one of the bankruptcy cases has indicated that she is inclined toward a ruling that the gathering agreements in question are not “covenants running with the land” (which were argued to protect the midstream company’s rights under its GPAs) and may be rejected. These cases are important to understand, and the bankruptcy process raises a number of key GPA questions and issues for upstream and midstream energy companies, based on their particular circumstances:

- What is the impact of a bankruptcy filing on GPAs?
- How does the automatic stay (i.e., the federal injunction which arises upon a bankruptcy filing) affect GPAs parties?
- What are the continuing performance obligations of the parties to GPAs once a bankruptcy is filed?
- What is required for GPAs to be “rejected” in a bankruptcy case?
- What is the impact and consequence when GPAs are “rejected”?
- Are GPAs restrictions on assignments enforceable in bankruptcy?
- Are GPAs minimum volume commitments enforceable in bankruptcy?
- Are GPAs covenants running with the land enforceable in bankruptcy?
- What law determines whether a covenant running with the land is valid and enforceable?
- How do 363 sales and plan sales affect the rights of GPAs parties?
- How can the GPAs’ parties protect their interests? Pre-bankruptcy filing? Post-bankruptcy filing?
- What are the potential rights of third parties and their impact on GPAs?
- What practical considerations arise when evaluating the relative rights of the GPAs parties and assessing potential business solutions vs. litigation?

These issues now emerging in the bankruptcy forum can be evaluated by experienced counsel to help parties manage the risk to GPAs when insolvency and bankruptcy arise.

For a copy of our slide deck on bankruptcy issues and midstream GPAs, please contact any of the following V&E Restructuring and Reorganization partners: Bill Wallander (RR Practice Group Leader, Dallas); Paul Heath (Dallas); Harry Perrin (Houston); or David Meyer / Steve Abramowitz (New York).

Recent bankruptcy cases (e.g., Sabine Oil and Gas, Quicksilver Resources) have raised issues regarding the viability of midstream gathering and processing agreements (GPAs) with upstream producers

– Published February 10, 2016

Full article available at:

<http://www.velaw.com/Insights/Gathering-and-Processing-Agreements---Bankruptcy-“Rejection”-Risk/>

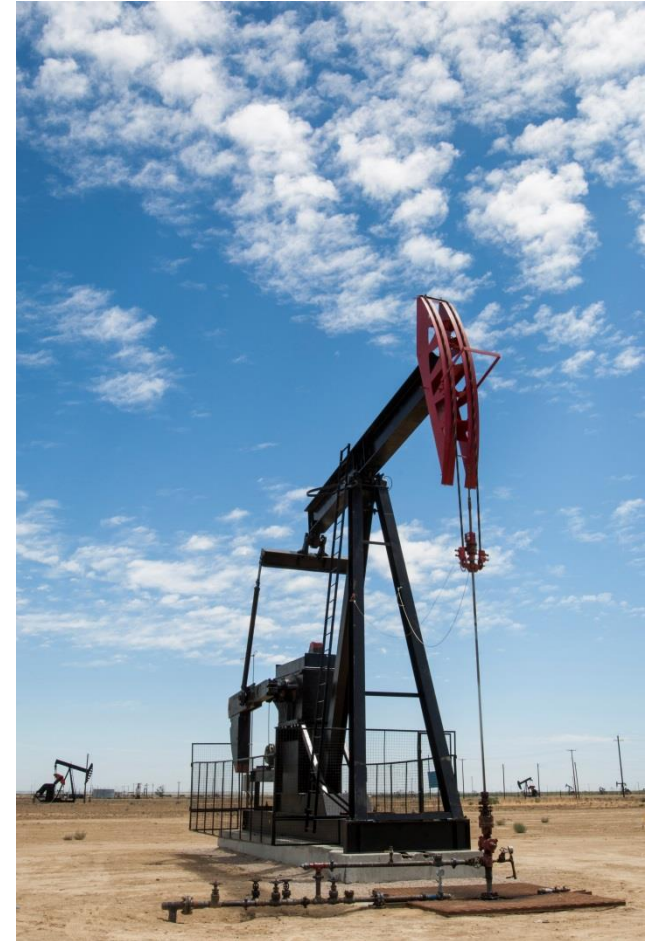
KEY CONTRACTS

- Gathering and Processing Agreements (GPAs)
 - Impact of bankruptcy filing / Automatic Stay
 - Rejection / Assumption of GPAs
 - Dedications and volume commitments
 - Covenants running with the land
 - Lien Priority and other security
 - Restrictions on assignment in GPAs



KEY CONTRACTS

- Joint Operating Agreements
 - Removal of operator
 - Impact on continuing operations
 - Advanced funds, JIBs and production revenue
 - Non-consent penalties
 - Covenants running with the land
 - JOA lien, lien priority and default provisions





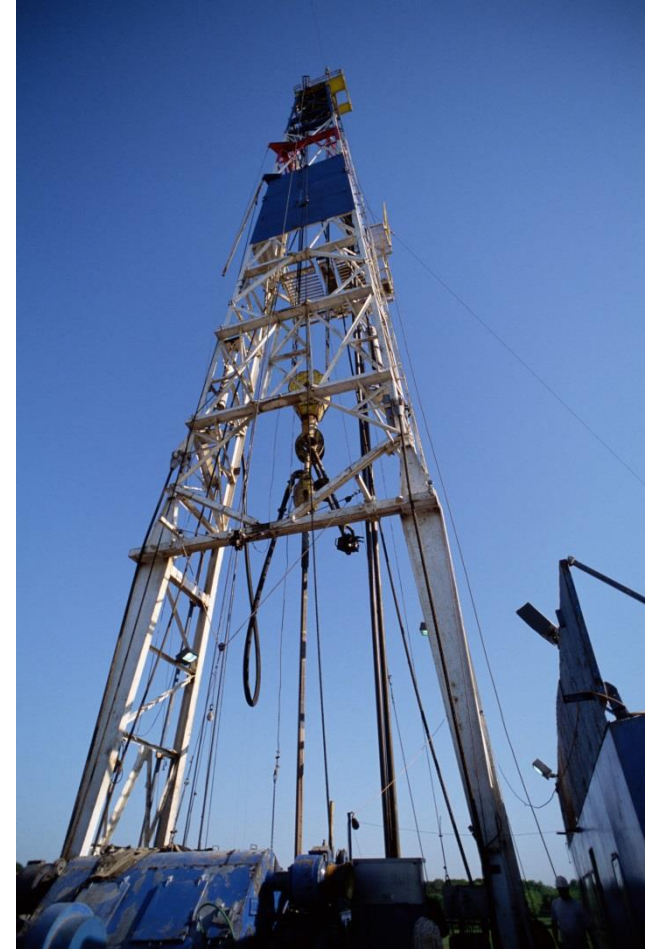
Bankruptcy Process Overview

BANKRUPTCY PROCESS OVERVIEW

- Types of Bankruptcy Filings
 - Chapter 7 (liquidation)
 - Chapter 11 (reorganization)
- Summary of Chapter 11 Bankruptcy Case
 - Case commencement (voluntary vs. involuntary)
 - First day hearings (ensure smooth transition into bankruptcy case)
 - Automatic stay (federal injunction)
 - DIP financing/cash collateral (estate funding)
 - Lien priority issues (collateral gaps, M&M lienholders)

BANKRUPTCY PROCESS OVERVIEW (CONT'D)

- Certain key issues in Chapter 11 Bankruptcy Case (cont'd)
 - Executory contracts (JOAs, leases, other)
 - Asset sales
 - Treatment of prepetition claims (vendors)
 - Disclosure statement and plan of reorganization (solicitation & voting effectuates reorganization or other restructuring transaction and discharge of debts)
 - Classification of claims (must be substantially similar to other claims in class, possibility for separate classification of substantially similar claims in some circumstances)
 - Voting (acceptance is 2/3 in dollar amount and 1/2 in number of allowed claims in class)
 - Post-confirmation activities
 - Preferences (unwinding preferential transfers)
 - Fraudulent transfers (actual vs. constructive, value issues)
 - A transaction may be implemented through a Chapter 11 plan (including by purchasing secured or unsecured debt) or outside a plan pursuant to section 363 of the Bankruptcy Code





363 Sales

UNIQUE ASPECTS OF A 363 SALES TRANSACTION

- Chapter 11 case can involve a sale of assets outside a Chapter 11 plan
- Stalking horse bidder – bidder that subjects proposal to topping bids and subject to court approval
 - Debtor conducts initial marketing process to find a stalking horse bidder
 - Stalking horse PSA is typically executed and attached to initial motion
 - Bid protections (1-3% of transaction amount) and expense reimbursement
 - Minimum bid increments
 - Stalking horse has right to match higher bids
 - Lenders may be the stalking horse bidder through a credit bid
- 363 Sale PSA
 - Highly negotiated
 - Effective Date purchase price adjustments
 - Treatment of title and environmental matters
 - Minimal reps and warranties
 - Limited post-closing recourse
 - Key stakeholders and other parties in contest may object to sale
 - Subject to court approval

UNIQUE ASPECTS OF A 363 SALES TRANSACTION (CONT'D)

- Treatment of executory contracts
 - Debtors may assume and assign certain contracts to purchaser
 - Cure costs
 - Assignment limited by applicable law
 - Dealing with pref rights
- Auction process
 - Additional marketing process to find bidders at the auction
 - Determination of qualified offers and court approved bidding procedures to govern process
 - Auction conducted
 - Winner signs up PSA with debtor, bankruptcy court approves transaction
 - Closing backup bidder
- “Free and clear”
 - Interaction with applicable state law, federal law, tribal law
 - Oil and gas leases and royalty obligations under state law
- Dealing with debtor's main creditor groups (secured creditors/committees of unsecured creditors)

ENERGY M&A

OVERVIEW



Market Leader

**Recognized in Nationwide
Energy: Oil & Gas
(Transactional)**
– *Chambers USA*, 2015

**Tier 1 in Mergers &
Acquisitions, Corporate Law
and Natural Resources**
– *U.S. News – Best Lawyers®
“Best Law Firms” Survey*, 2015

**Recognized in Energy:
Transactions**
– *Legal 500 U.S.*, 2015

By the Numbers

60%

Over **60%** of V&E's lawyers
work in the energy and
natural resources sector

1

Five **band 1** energy rankings in
Chambers Global 2015

U.S. Energy M&A Transactions 2010 – 2015

RANK	FIRM	VALUE (USD M)	NO. OF DEALS
1	Vinson & Elkins	329,082	303
2	Latham & Watkins	291,777	203
3	Baker Botts	357,233	142
4	Akin Gump Strauss Hauer & Feld	84,727	124
5	Andrews Kurth	99,683	106
6	Bracewell & Giuliani	230,244	97
7	Jones Day	73,018	88
8	Skadden Arps Slate Meagher & Flom	118,794	76
9	Thompson & Knight	39,278	66
10	Kirkland & Ellis	50,904	58

mergermarket: as of December 31, 2015
includes only publicly-disclosed transactions

THANK YOU

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