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Spring Energy & Commodities Conference

April 6, 2016

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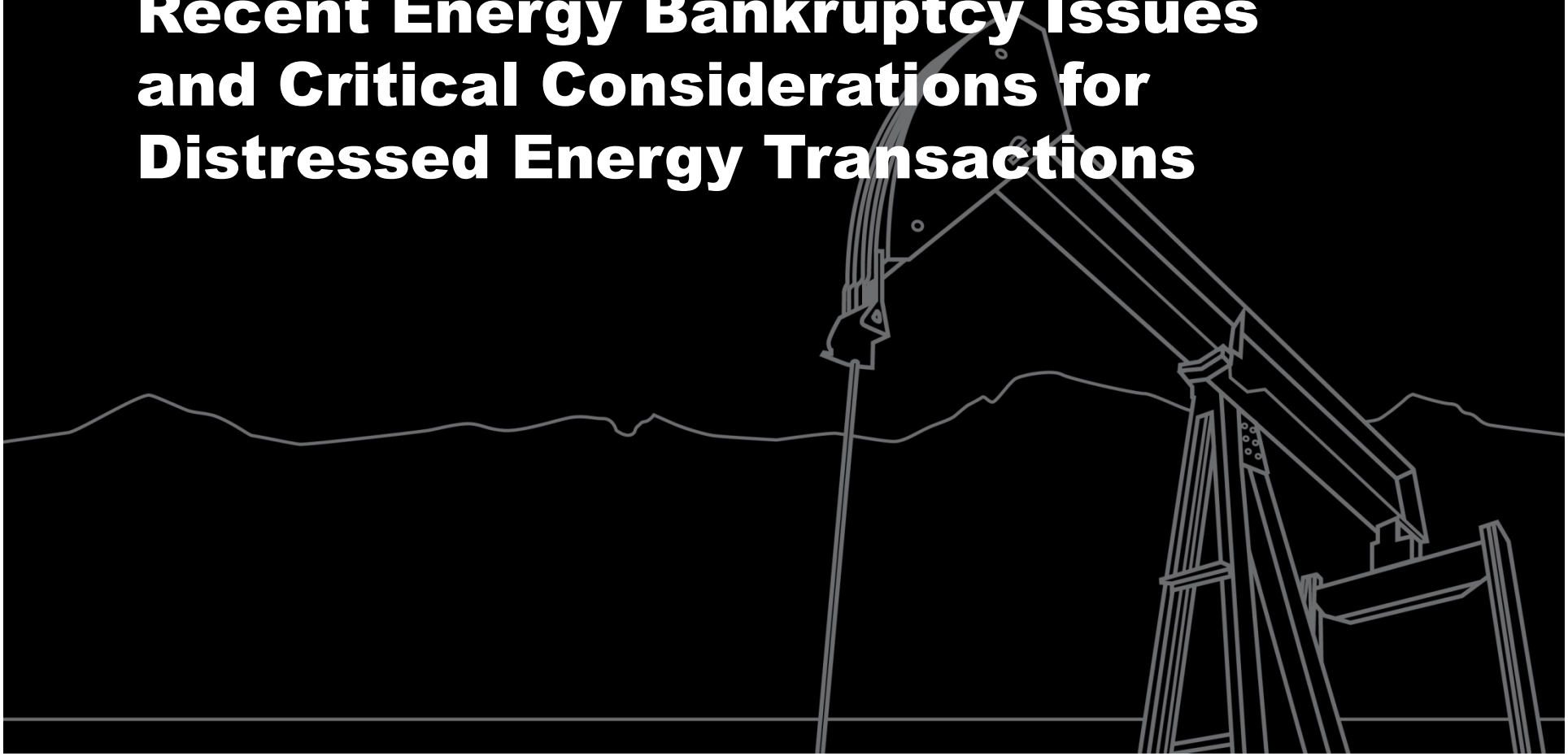
Panel Two:
Recent Energy Bankruptcy Issues and Critical Considerations for Distressed Energy Transactions



Panelists

- Moderator: Chad Mills, Cadwalader
- Ingrid Bagby, Cadwalader
- Tania Perez, Cadwalader
- Raj Thapar, Partner, TDF Partners LLC

Agenda

I. Introduction

II. Commodity pricing and commercial trends

III. Valuation and Pre-Bankruptcy Dynamics

- Drawdowns on RBLs
- Developing Market for RBLs
- 1.5 Lien Loans

IV. Issues in Chapter 11

- Treatment of Midstream Contracts
- Lien Priority
- Section 363 Sales – What is “Free and Clear?”

V. FERC issues and Sabine pipeline decision

VI. Q&A

Commodity Pricing and Commercial Trends

TDF PARTNERS

Energy Turnaround &
Restructuring Advisors

Challenges facing the Energy Sector

- Global oversupply leading to a sharp decline in commodity prices is threatening the survival of many companies in the oil and gas sector
- Success of shale drilling, overproduction by Saudi Arabia and Russia and slowing Chinese demand have all contributed to this oversupply
- The contagion that started with service companies is now spreading to producers and will eventually impact midstream sector as well
- Capital structures as well as thousands of contracts will need to be renegotiated in line with the current economic reality
- Frozen debt markets and low prices are likely to persist longer than the liquidity of many E&P, Midstream and Oil Field Service companies

Slide in Oil Prices

- Price has gone from $107/barrel in 2014 to $30/barrel in 2016
- This has essentially been a supply driven event
- Supply side of the equation is the main issue - production has grown materially both in the US and internationally
- US production increased from 5.5mbd in 2010 to 9.3mbd in 2015. US actually grew production while the price decreased 70%!
- Demand for oil is stable and in fact growing - just not as fast as before or expected

Amount of Oil in Storage Tells it All

- The supply demand imbalance is easily seen in the global storage status
  - Above ground storage of oil outside the US is virtually full
  - US above ground storage is at 500 million barrels in storage - highest level in 80 years
  - The US government holds another 700 million barrels
  - Floating storage is believed to be fully utilized as well

Price Action Going Forward

- Price must move lower first to sideline more production
- If OPEC and other players will not moderate production then the price will move lower to shut off more US production - only 400,000 to 500,000 barrels came off in the move from $100 to $30
- When supply demand is in balance the storage is reasonably drawn down the prices will migrate the to the $50 to $60 - then back down to $30 - this oscillation will occur a number times
- Long range price is more than like $50 to $70 barring a significant geo-political event (which is a real risk) or a supply dislocation by a major player in the supply stack

Likely Scenario for 2016-2017

- The US oil and gas industry is experiencing negative financial stress now and will continue to experience that stress for the next several years - the dominant factor is an over-supply of crude oil

- This stress will not just impact E&P companies but midstream and the oilfield services as well

- Market participant balance sheets are severely over leveraged and we do not see the market changing to alleviate that issue in the near term - they were structured in expectation of a $70 - $100 crude market - we anticipate the market to be in $ 25 - $40 range in the near term (until the supply / demand imbalance is addressed) , and certainly $70 and lower for an extended period of time

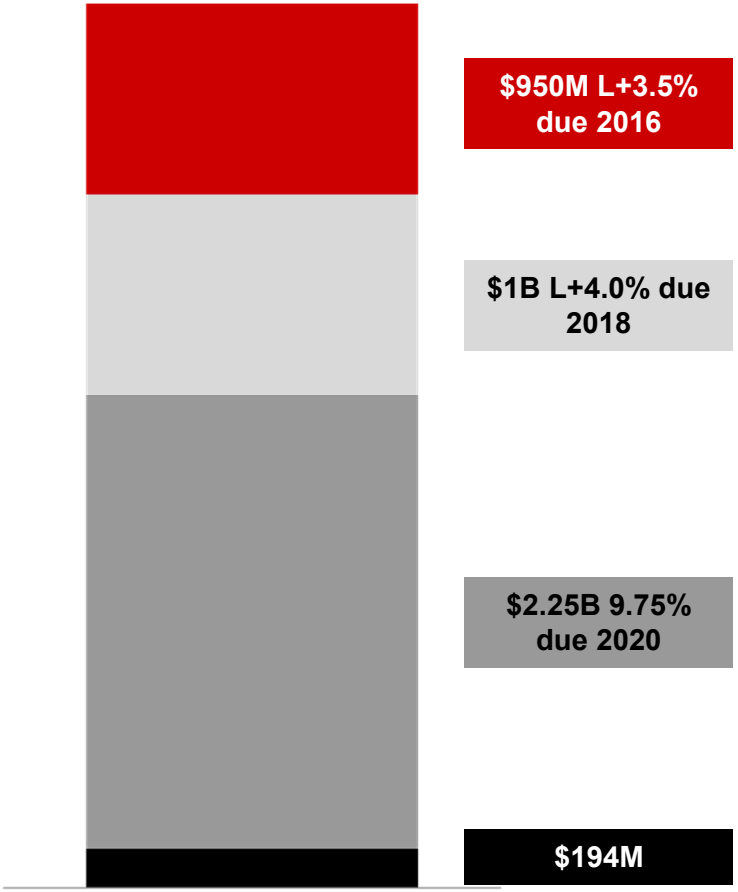
- Cash flow for many market participants is insufficient to meet debt service and operational requirements at the same time - this is due to the reduction in reserve based borrowing, rolling off of production hedges and a sharp reduction in cash flow from operations

Lower for Longer - U Shaped Recovery

- Market consensus suggests that low oil prices are likely to persist for longer than previously assumed
- This commodity price cycle is expected to have a U shaped bottom with a lot of volatility. The shake out could take 24 months or possibly longer
- At a minimum many market participants will require balance sheet restructuring of some type and some of those market participants will require some form of operational restructuring
- Thousands of contracts between the producers on one side and the service and midstream companies on the other, will need to be renegotiated to come in terms with the new economic reality
- 2016 will see significantly more exploration & production and other midstream and services company bankruptcies and restructurings

Valuation and Pre-Bankruptcy Dynamics

Samson Resources Capital Structure



Capital Structure[1] (000s)			
	Coupon	Face Amount	Maturity
Reserve Based Revolver[2]	L+3.5%	$950	21 Dec 2016
Second Lien Term Loan[3]	L+4.0%	1,000	25 Sep 2018
Total Secured Debt		**$1,950**	
Senior Unsecured Notes	9.75%	$2,250	15 Feb 2020
Total Debt		**$4,200**	
Cash and Cash Equivalents		$194	
Net Debt		**$4,006**	

Source: Company filings, Debtwire.
[1] As of March 31, 2015.
[2] As of March 31, 2015, Samson Resources had no available borrowing capacity on its RBL revolver. On its revolver, Samson had $2B letters of credit outstanding.
[3] Subject to a 1% LIBOR floor.

Cash is King for Distressed Oil and Gas Companies

Numerous oil and gas companies have drawn down all, or substantially all, of their revolving credit facilities in advance of potential restructurings in recent months…

LINN Energy *

MIDSTATES PETROLEUM

ULTRA PETROLEUM

STONE ENERGY *

SANDRIDGE *

Chaparral ENERGY *

SWIFT ENERGY COMPANY *

sabine oil & gas *

…Many of which subsequently announced they would review strategic alternatives, restructure debt, or have filed for bankruptcy.

Why are banks still funding draws?

* Exploring strategic alternatives, debt restructuring or has filed for bankruptcy.

Issues in Chapter 11

Key Legal Issues in Chapter 11

What is Property of the Estate?

- Bankruptcy Code section 541 provides that upon a filing, an "estate" is created consisting of the debtor's property, wherever located or held.
- Does a transaction constitute a secured financing or a sale? If a financing, the property may remain in the debtor's estate.
- Significant pre-petition transactions may be challenged, in an attempt to increase the size of the estate to the benefit of creditors (*e.g.*, fraudulent transfers).

Lien Priority & Perfection

- Unperfected liens may be challenged to further increase the size of the estate and property available for all creditors.

Impact of Intercreditor Agreements

- May inform junior creditors' ability to take positions counter to those of senior creditors, or to contest senior liens.
- Limitations on collateral rights, adequate protection waivers, advance consents to actions by senior creditors, limitations on chapter 11 plan voting rights.

"Safe Harbor" Protections

- Certain energy contracts, such as swap agreements/commodity forward agreements, may qualify for Bankruptcy Code "safe harbor" protections.
- On debtor's default, counterparties may exercise their rights to collateral despite the automatic stay.

FERC Issues and Sabine Decision

Decision on Contract Rejection in In re Sabine Oil & Gas Corp.

Situation Overview

- On July 15, 2015, Sabine Oil & Gas Corporation, an independent oil and gas company engaged in the acquisition, production, exploration and development of onshore oil and natural gas properties in Texas, filed for chapter 11 bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York.
- On September 30, 2015, Sabine filed a motion under section 365 of the U.S. Bankruptcy Code seeking to reject certain midstream gathering and processing agreements with Nordheim Eagle Ford Gathering, LLC and HPIP Gonzales Holding, LLC.

Key Issues

- Section 365 of the Bankruptcy Code allows a debtor, subject to the court's approval, to assume or reject executory contracts and unexpired leases.
  - Rejection is considered a prepetition breach, resulting in a general unsecured claim for damages arising from such breach.
  - Rejection permits debtors to shed burdensome contracts and leases and pay any remaining obligations in "bankruptcy dollars".
  - Rejection must be a reasonable exercise of the debtor's business judgment.
- However, "covenants that run with the land" are not subject to rejection, as they are interests in property.
  - Whether a gathering agreement is an executory contract or a covenant that runs with the land will be determined by state law.
  - In Texas, for example, "[o]il and gas are realty when in place and personalty when severed from the land by production." Riley v. Riley, 972 S.W.2d 149, 155 (Tex. App. 1998).
- Sabine debtors sought to reject two gathering and processing agreements, and the midstream contract counter-parties objected, in part, on the basis that the agreements contained "covenants that run with the land."

Decision on Contract Rejection in In re Sabine Oil & Gas Corp.

Ruling

- Bankruptcy Judge Shelley Chapman of the Southern District of New York ruled that Sabine can reject the two gathering agreements at issue.
  - There was insufficient evidence challenging the debtors' business judgment to reject the contracts because the agreements were no longer financially viable for the debtors.
  - Procedural issues prevented Judge Chapman from issuing a finding on Texas property rights in the agreements. However, the Court did set forth its non-binding analysis of why the gathering agreements should not be considered "covenants running with the land."

Court's Covenant Analysis

- There was no horizontal privity because (i) the debtors did not reserve any interests for midstream companies, and instead engaged them to perform specific services; (ii) the agreements do not grant midstream companies a real property interest in the debtors' mineral estate, and therefore the debtors did not transfer any portion of their real property interests to midstream companies through the agreements.
- The agreements do not touch and concern the land because (i) the obligation to pay a transportation fee was triggered by the receipt of gas by the services provider's facilities rather than by the flow of gas, and (ii) the debtors were using trucks, instead of the gathering system, to transport products.

The Court's decision is non-binding on the nature of the midstream agreements. Each contract's language needs to be reviewed carefully under applicable state law.