68th ANNUAL OIL & GAS LAW CONFERENCE

February 16-17, 2017

Houston, Texas

Chapter 11

Acquiring Oil and Gas Assets From a Distressed Seller Outside of Bankruptcy

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Table of Contents

§11.01 Introduction 1

§11.02 Identifying the Distressed Seller 4

§11.03 Transaction Risks for a Buyer or Seller Where the Seller Is in Financial Distress 8

§11.04 Structure of the Acquisition 11

§11.05 Confidentiality Agreements 14

§11.06 Exclusivity or No-Shop Provisions 16

§11.07 Risks to the Buyer Notwithstanding A Good Sale Process 19

§11.08 Environmental Claims and Royalty and Tax Claims 24

§11.09 Issues Relating to Gathering Agreements and the Sale of Assets 26

§11.10 Tax Payment Issues 28

§11.11 Environmental Claims 31

§11.12 Successor Liability Issues 33

§11.13 Fraudulent Conveyance Risks for the Purchaser 36

§11.14 Conclusion 42

§11.01 Introduction

Over the last seven years the price for oil and gas has fluctuated wildly in the United States and around the world. In June, 2008, the per barrel price of oil peaked at over $150 per barrel.[1] The price then collapsed dramatically beginning in late summer 2008 (as did the world's economy), hitting the mid-40's per barrel by January, 2009. At that point, the price began a moderate but steady climb through April, 2011, when the price hit $121.67/barrel. From there, the price was relatively stable and the price hovered around $100/barrel for the next three years. At the same time, central banks around the world kept interest rates at zero and with the increased likelihood of production provided by the combination of horizontal drilling and fracking, E&P companies gorged themselves with new debt to support ambitious drilling programs.[2] The drilling worked and production skyrocketed and in the United States alone, four million barrels per day of additional oil hit the market. A huge glut of oil was created and predictably, prices collapsed again.

The price began to drop in May, 2014, steadily decreasing from $104.95 per barrel to $49.37 per barrel in January, 2015. Over the next 12 months, the price continued to decrease, eventually reaching $26.21 per barrel in February, 2016, some 75% below its price just 19

[1] Currently, there are two main price indices for oil pricing – Brent Crude ("Brent") and West Texas Intermediate ("WTI"). Brent originally referred to the Brent oilfield in the North Sea off the coast of the United Kingdom though there are now a number of North Sea fields that are included in that index which is viewed as more global than WTI and as having a transportation advantage versus WTI. WTI refers to the oil produced in the United States and generally stored in Cushing, Oklahoma. While slightly lighter and sweeter than Brent oil, the WTI currently sells for a slight discount to Brent given the higher transportation costs given the landlocked nature of WTI oil.

[2] By some estimates, in 2015 U.S. oil and gas companies had $850 billion in outstanding bonds plus over $1.5 trillion in syndicated bank loans. See generally, *Stop Propping Up Zombie Oil Companies,* http://www.forbes.com/sites/christopherhelman/2015/03/26/stop-propping-upzombie-oil-companies/

months earlier. Since February, 2016 and early 2017, the price has increased and now, with the assistance of OPEC, seems to hover with some consistency around $52-53 per barrel.[3]

However, the fluctuations noted above in the price of crude oil had done their damage. Many of the U.S. producers had loaded up their balance sheets with debt – both secured reserved base loans ("RBL") and large tranches of senior unsecured debt securities. With respect to the RBL facilities, the inevitable borrowing base redeterminations required in the spring and fall of each year decreased the liquidity of the E&P companies.[4] With less funds to support drilling programs and increased production, cash flow further diminished and covenant defaults ensued under both the RBL facilities and any debt securities. While many companies attempted to reach out of court restructurings with their lenders and noteholders, during 2015 and 2016, there were 232 bankruptcy filings in North America among E&P, mid-stream and oil field service companies.[5] These bankruptcies involved over $96.2 billion in secured and unsecured debt. In addition to the raw economics that result from the collapse in prices, there are other distress triggers that continue to impact the industry – quarterly covenant certifications, hedges expiring, drilling requirements to maintain leases and little if any room from service providers to grant concessions.

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[3] On November 30,2016, OPEC announced that its members had reached agreement to cut production for the first time in over 8 years, sending per barrel prices back up over $50 per barrel where the prices appeared to have stabilized.

[4] See generally, Haynes and Boone, LLP, *Borrowing Base Redeterminations Survey: Fall 2016.* Available at www.haynesboone.com.

[5] See generally, Haynes and Boone, LLP, *Special Year-End Edition – Oil Patch Bankruptcy Monitor, Oilfield Services Bankruptcy Tracker and Midstream Report, December, 2016.* Available at *www.haynesboone.com*. Hereafter, "*Haynes and Boone Year-End Report.*"

With this as a backdrop, the options available to oil and gas producers in the restructuring tool box are limited if the company desires to attempt to retain any value for its shareholders.[6] For some, as we discuss in this paper, asset divestitures may provide limited relief. However, for most of the larger players in the current downturn, asset sales rarely provide the required balance sheet relief and access to growth capital as the net proceeds received from the sales at current price levels are simply inadequate. More frequently, most of the larger distressed producers today are pursuing balance sheet restructurings either outside of the Bankruptcy Court or more frequently, as part of a pre-negotiated or pre-packaged bankruptcy with the benefit of a fully negotiated restructuring support agreement[7] among the large creditor groups (the banks and the bondholders). These plans, recognizing the overleveraged and insolvent status of the company, result in a restructured company with new shareholders, new balance sheet, exit financing and the equity of the old company divided up among the constituent creditor groups based on the priorities that would prevail in a standard bankruptcy analysis. Billions of dollars of debt are shed in the process. However, among the smaller E&P companies as well as a few of the larger companies, asset sales are still pursued, and as of April, 2016 there had been 49 asset

[6] In addition to the problems created by the sheer amount of debt burdening these companies, the use out of court restructurings involving debt exchange offers and consent solicitations were further limited by two district court opinions in the Southern District of New York in 2014 and 2015. These decisions, known as the Marblegate decisions, interpreted §316(b) of the Trust Indenture Act and reversed decades of precedent in holding that non-consensual amendments to an indenture's core terms were prohibited if the amendments impaired the noteholders' practical ability to receive payment. Historically, such non-consensual amendments were permitted if the core payments terms were left intact - a standard which enabled out of court debt exchanges to proceed more easily. See, *Marblegate Asset Management, LLC v. Education Management Corp., et al.,* 111 F.Supp.3d 541 (D.Crt. S.D.N.Y. 2015). On January 17, 2017, the Second Circuit Court of Appeals reversed the District Court and, after a lengthy analysis of the legislative history of §316(b) of the Trust Indenture Act, held that the prohibition found in §316(b) only prohibited non-consensual amendments that changed the indenture's core terms. *Marblegate Asset Mgmt, LLC v. Education Mgmt. Fin. Corp.*, Docket No. 15-2124-cv(L), (U.S. 2nd Cir. Court of Appeals, January 17, 2017).

[7] A restructuring support agreement is a pre-petition agreement between a company and certain of its creditors that generally contains the material terms of a Chapter 11 plan to be proposed and supported by the signing creditors and frequently includes DIP terms, timing milestones, management expectations, and the outlines of the expected debt conversion and exit strategy for the Chapter 11 debtor.

transactions (not including mergers) for $12.7 billion in 2016, up from 35 assets deals worth $6.5 billion in 2015.[8]

We now turn to the topic of this paper – acquiring oil and gas assets from a distressed seller outside of bankruptcy. The financial distress of the seller can be the result of many causes – a lack of working capital caused by decreased revenues, increases in operational costs, a redetermination of the borrowing base under the company's revolver, decreased drilling because of collapse in oil and gas prices, an inability to meet interest payments on the company's debt – whether the RBL lender, the second lien holder or the bondholders. The list could go on. More likely than not, in today's world, the oil and gas company that pursues the asset sale path as a remedy for its financial distress is probably a smaller company with a relatively uncomplicated balance sheet and a belief that the sale of assets is the best way to reduce its debt load and to resist the financial headwinds confronting the company. In any event, there is a decision by the company (with a little help from its lenders no doubt) that it must retain an industry consultant, evaluate its options and sell assets as a first step to put its financial house in order and it needs to proceed rapidly.

§11.02 Identifying the Distressed Seller

For our purposes, we will assume that the seller is not in bankruptcy and not subject to any receivership proceedings. Signs of distress in public companies are more easily detected given the extensive periodic reporting requirements imposed on public companies by the Securities and Exchange Commission ("SEC"). Long before any breach of a material obligation of the company, the company's quarterly and annual reports plus any required filing brought

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[8] See generally, *Slowly, Distressed Oil and Gas Companies Look to Asset Sales as Oil Hits $50.* http://www.forbes.com/sites/maxfrumes/2016/06/08/slowly-distressed-og-companies-increasingly-look-to-asset-sales-as-oil-hits-50/.

about because of material events, should have informed the company's investors and other interested parties of the company's financial situation. If, for example, the company defaults under its credit agreement or enters into a forbearance agreement, the 8-K filing required by applicable SEC regulations will so advise the world. Additionally, if the company has publicly traded debt securities, the ratings of the debt will likely be down-graded by the applicable ratings agencies providing further notice of the economic distress of the company.

Other than a bankruptcy filing or SEC disclosure for a public company, there are a variety of other signs that evidence the distressed company. While the most obvious signs of distress relate to excessive debt levels, there can be other indicators of financial distress that may be evident. Does the company suddenly replace its CFO or accountants? Is a workout person or restructuring officer brought on board? Are there layoffs and what is the word on the street? If the company is overleveraged, was this caused by changes in costs, the collapse in oil prices or simply poor management? Or both?

If the company is subject to covenant defaults under its RBL facility or a borrowing base redetermination that requires a prompt pay down, it is common for the company and its lenders (both the senior and second lien lenders, if any) to have entered into forbearance agreements or amendments to credit agreements that will provide limited relief for the borrower in exchange for its focused efforts to reduce debt through either a capital raise or sale of assets. In addition, the lenders will require all manner of cost reductions for capex, service providers, salaries to key employees, headcount reductions as well as reduction of any discretionary spending. With a shortage of funds, drilling programs are an early casualty which inevitably creates diminished revenue and may put at risk the retention of certain oil and gas leases. Obviously, finding willing investors, even "vulture investors," can be difficult if not impossible as savvy investors will not

fund into a distressed company for fear of losing the investment. For many, the next step is to pursue aggressively asset sales.[9] In the current environment, by the time many distressed companies initiate capital raising or asset sale efforts, their overall debt burden may be too high for an investor to consider a new investment. The company will no doubt require working capital for drilling programs or acquisition efforts and no thoughtful investor will want to see its new investment simply reduce debts or not otherwise have the benefits of a restructured balance sheet.[10]

There are various other signs of financial distress that may become apparent. Larger trade vendors frequently require copies of quarterly financials that were delivered to a company's lenders. If the company gets behind in payments to its service providers, those parties may file mechanics or materialmen's liens against the company's real property.[11] If the company is not the operator, the operator of properties can protect itself by recording the joint operating agreement ("JOA") or a short form memorandum of the JOA in the county records as well as seeking to perfect a lien on personal property by filing an appropriate financing statement.[12] For public companies, the SEC filings will likely provide all the information that any creditor could

[9] Certain private equity firms have used creative financing techniques to fund drilling costs by investing in the company and receiving non-operating working interests and leaving the company with a carried interest. Once the lender/investor receives the negotiated return, the investors working interest drops and the company's reverts to the larger percentage. See Banerjee, Devin, *Blackstone's GSO Commits Up to $500 Million for Oil Drilling,* Bloomberg, Jan.2, 2015, http://www.bloomberg/news/articles/2015-01-02/blackstone -commits-up-to-500-million-for-oil-drilling-with-linn.

[10] One tactic frequently used by distress investors in the current downturn and balance sheet insolvencies is to purchase the public debt of the distressed company at a discount with the expectation that they will be able to take over the company in a Chapter 11 proceeding through the exchange of its traded debt for the equity of the reorganized debtor. This is sometimes done in a pre-packaged bankruptcy where the debt holders exchange their debt for equity in the reorganized company.

[11] "Mechanics' lien" as used herein refers to mechanics', materialmen's, laborers' and other statutory liens that grant automatic liens to service providers who provide services to owners of real property. See generally, Hendrix, Lynn P., and Robinson, Peter D., *Mechanics', Materialmen's and Other Statutory Liens,* Dealing With Financial Distress in the Oil & Gas Industry, Paper No. 7, (Rocky Mt. Min. L. Fdn. 2010).

[12] See generally, Munoz, Jeffrey S., and Taldykin, Nikita S., *Best Management Practices – Securing Your Position,* Dealing With Financial Distress in the Oil & Gas Industry, Paper No. 3 (Rocky Mt. Min. L. Fdn. 2010). It is a preferred practice for any operator to protect its position by recording the JOA or a short form memorandum even in the best of times – as times do change.

require to determine the financial health of the company. Those financials, along with any management discussion, are an outward sign which may cause the vendor to impose tighter credit terms, letters of credit or COD payments. Once the word gets out in the trade vendor community that a company is having cash flow difficulties, the word travels quickly and other significant suppliers will likely tighten their credit terms, further impairing the company's cash flow. This may occur while the company is attempting to preserve cash or accelerate debt repayments from asset sales to bring the company into compliance with its loan covenants or its re-determined borrowing base under its RBL facility.

If a company has properties in multiple locations, it is not unusual to see the company selling discreet asset packages to pay down its debt. An E&P company may sell its drilling affiliate in an effort to raise cash or otherwise dispose of asset groups in an effort to pay down debt but survive as a going concern. The company may offer service providers overriding royalty interests or working interests in properties in lieu of payment. Frequently, the company will have retained a broker or investment banker to market the properties or groups of properties or to consider other "strategic alternatives." The sales process undertaken by the seller will give a clear indication of whether the sale is a distressed sale.[13] A review of the materials provided in any data room will be instructive, especially the financial statements which hopefully are audited.

Obviously, a going concern qualification to a company's financials should raise concerns for the parties – both the buyer and the seller. Operationally, care should be taken that the troubled seller has not failed to operate its properties in compliance with applicable

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[13] As discussed below, the duties of the board of directors differ when the company, as seller, is insolvent or in the zone of insolvency. This will impact the timing and the nature of the sale transaction.

environmental regulations, failed to produce wells held by production or otherwise allowed its trade debt to accumulate. Where the economic distress arises from cash flow shortages that lead to operational problems as opposed to covenant default issues, increases in trade payables are likely, with the delinquent payables frequently manifesting themselves as liens for labor and materials supplied.[14] Some vendors may have initiated foreclosure proceedings or brought suit on open accounts. In either case, these sorts of trade payable problems are generally very readily discerned by a review of the financials, county filings and from discussions among the vendors and service providers.

§11.03 Transaction Risks for a Buyer or Seller Where the Seller Is in Financial Distress

As a preliminary matter, it is well known that whether a corporation is solvent or insolvent (or somewhere in between), directors owe fiduciary duties to the corporation itself. And, depending on whether the company is solvent or insolvent, directors owe fiduciary duties to the shareholders or the creditors of the company.[15]

The two primary fiduciary duties are (i) the duty of care and (ii) the duty of loyalty. The duty of care requires that directors reasonably inform themselves of all relevant information and

[14] As noted above, these liens would generally be either mechanic's or materialman's liens, or in some jurisdictions, oil and gas well liens. Most mineral producing states have special oil and gas lien statutes. *See, e.g.*, Colo. Rev. Stat. §§ 32-24-101, *et seq.*; KAN STAT. ANN. § 55-207 (1983); LA. REV. STAT. ANN. §§ 9:4861-4867 (West 1983 & 1987 Supp.) MONT. CODE ANN. §§ 71-3-1001 to -1002 (1987); NEB. REV. STAT. §§ 57-801 to -820 (1984); N.M. STAT. ANN. §§ 70-4-1 to -15 (1978); OKLA. STAT. ANN. tit. 42, §§ 144-146 (West 1979 & Supp.); TEX. PROP. CODE ANN. §§ 56.0001-.045 (Vernon 1984); UTAH CODE ANN. § 38-10-101 to -115 (Supp. 1987); WYO. STAT. §§ 29-3-101 to -111 (1981). Like many states in the Rocky Mountain region, Colorado has both a general mechanic's lien statute, COLO. REV. STAT. §§ 38-24-101 to -133 (1982), and an oil and gas lien statute, COLO. REV. STAT. §§ 38-24-101 to -111. Colorado's oil and gas lien statute provides for a lien in favor of persons or entities that have provided labor or certain specified materials for operations on or in connection with oil and gas properties. COLO. REV. STAT. § 38-24-101. The lien statement, which must be filed in the county clerk's office within six months after the materials or labor have been furnished, must contain an account of the amount due, a description of the property charged with the lien and the affidavit verifying the information. COLO. REV. STAT. § 38-24-104. In Colorado, the lien created does not extend to the proceeds of the sale of minerals produced from the lease in question. *Chambers v. Nation*, 178 Colo. 124, 497 P.2d 5 (1972).

[15] *See, generally*, 3A William Meade Fletcher, *et al.*, *Fletcher Cyclopedia of the Law of Corporations* § 1035 (2008).

options available to the company before making a decision. The duty of loyalty requires that directors act in good faith for the benefit of the corporation and its stockholders. Directors must not take actions in their own self-interest that may injure the corporation or its shareholders or deprive the shareholders of an opportunity that may be available.[16] The duty of loyalty also prohibits self-dealing by officers and directors. Where the corporate structure involves a parent and subsidiary corporation, where the subsidiary is solvent, the directors of the solvent subsidiary are only obligated to manage the subsidiary for the best interests of the parent, even if that is to the detriment of the subsidiary.[17]

While the certificate of formation for a Delaware corporation can limit directors' personal liability for breaches of the duty of care not involving intentional or bad faith acts by the directors, such protections are not available with respect to breaches of the duty of loyalty.[18] Nor are breaches of the duty of loyalty protected by the business judgment rule. In making their business decisions and complying with their duty of care and duty of loyalty, directors are entitled to rely on management and outside experts so long as the directors' reliance is in good faith and with an honest belief that the action taken or the decision made was in the best interests of the corporation. This is the business judgment rule[19] and it protects the directors even if the action taken ultimately proves unsuccessful. This presumption can be overcome where it is

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[16] A simple example of a breach of the duty of loyalty is when a director/officer pursues a management buy-out of the company or a going private transaction without implementing the necessary procedural safeguards such as a special committee to evaluate the transaction coupled with a market check of the proposed transaction.

[17] See *Lightsway Litigation Service, LLC v. Yung (In re Tropicana Entm't, LLC)*, 520 B.R. 455 (Bankr. D.Del. 2014).

[18] *See* DEL. CODE ANN. tit. 8 § 102(b)(7) (2001); see generally, D.J. Baker, John W. Butler, Jr., and Mark A. McDermott, *Corporate Governance of Troubled Companies and the Role of Restructuring Counsel*, 63 BUS. LAW 855 (2008) (hereinafter, the Baker Article).

[19] *See* DEL. CODE ANN. tit. 8 § 141(e) (2001). See also, *In re Caremark Int'l Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

shown that a director was grossly negligent by failing to act in good faith, on an informed basis or in the best interests of the corporation.

While a company is solvent, these duties and other applicable board duties such as the duty of good faith and duty of oversight, protect the shareholders and not the creditors. The creditors' rights derive from their contractual relationships and agreements with the company. In addition to their contractual rights, creditors are also protected by corporate law that limits dividends that would "impair the capital" of the company and by applicable fraudulent conveyance laws. However, as a corporation slides towards insolvency, duties and rules applicable to the directors and officers shift or expand "to the firm and its 'entire community of interests,' including creditors."[20] The concept of shifting constituents when a corporation is insolvent or in the zone of insolvency has generated substantial discussion and commentary since it first surfaced in the *Credit Lyonnais* opinion in 1991.[21] For those interested in this meandering history of shifting fiduciary duties, please see the Willett Article and the Baker Article.

Greenwhalla has clarified that the directors' duties do not "shift" as the company approaches insolvency such that a creditor would have a direct claim against the officer or directors for breach of duty while the corporation is in the "zone of insolvency." Creditors of an insolvent company can only assert derivative claims on behalf of the company against directors for alleged breach of fiduciary duties, in essence taking the place of the shareholders of a solvent

[20] Baker Article at 858. But see Sabin Willett, *Gheewalla and the Directors' Dilemma*, 64 BUS. LAW. 1087 (2009). Ms. Willett argues that the 2007 Delaware Supreme Court opinion *N. Am. Catholic Educ. Programming Fund v. Gheewalla*, 930 A.2d 92 (Del. 2007) (hereinafter *Gheewalla*) makes clear that even when insolvent, creditors do not have direct claims against officers and directors for breach of fiduciary claims. A recent California Court of Appeals decision held that directors of an insolvent California corporation owed no special fiduciary duties to creditors. See *Berg & Berg Enters., LLC v. Boyle*, 2009 WL 3470631, at 11 (Cal. Ct. App. Oct. 29, 2009).
[21] *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, No. 12150, 1991 WL at 277613, at 34 (Del. Ch. 1991).

company as the injured party for damages incurred by the breach of duty.[22] This result is consistent with the reality that in the context of a sale of a company or liquidation, unless and until the claims of the creditors are satisfied, no economic value should go to the shareholders.[23] Careful directors of troubled companies should take into account their creditors and other constituents and realize that their actions will be scrutinized by a broad range of parties in determining whether their actions have maximized value for the appropriate groups.

When considering the acquisition of assets from a distressed oil and gas company, the informed buyer should focus on the issues that involve creditor claims against the selling company with special attention on claims that could impact properties transferred. The buyer will want to acquire the properties free and clear of all liens, claims and encumbrances. If that can be accomplished, then many, but not all of the creditor/solvency issues (at least as to the properties acquired) will have been addressed. While the overall insolvency of the seller can still be an issue and bring into consideration fraudulent conveyance concerns as discussed below, payment of claims with respect to the properties transferred is an important first step in any distressed acquisition.

§11.04 Structure of the Acquisition

Sales of oil and gas properties have historically been structured as asset sales.[24] For the distressed seller, the choice of transaction structure will likely be driven by whether the

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[22] Citing the Delaware LLC Statute, the Delaware Supreme Court affirmed that creditors of an insolvent limited liability company do not have standing to bring derivative claims on behalf of the LLC – those rest exclusively with the members of the LLC. *CML V, LLC v. Bax,* 28 A. 3d 1037 (Del. 2011), *aff'g* 6 A. 3d 238 (Del. Ch. 2010).

[23] There are two traditional tests for insolvency: the equity or cash flow test – a company is insolvent if it is unable to pay its debts as they become due, or the balance sheet test – a company is insolvent if its liabilities exceed the value of its assets at a fair valuation. The Bankruptcy Code utilizes the balance sheet test. 11 U.S.C. § 101(32).

[24] Howard L. Boigon and Paul Hilton, *Structuring Oil and Gas Property Acquisitions: Stock Transactions Versus Asset Sales*, Paper 7, RMMLF, Special Institute on Oil and Gas Agreements: Sales and Financings (May 2006) (hereinafter Boigon and Hilton).

properties sold constitute substantially all the assets of the company, would the sale proceeds be maximized by separate assets sales to multiple buyers, and what is the best way to consummate a transaction given the seller's obligations to its creditors.[25] Additionally, the increased use of Chapter 11 to effectuate asset sales or change of control transactions, will impact the parties' selection of a sale structure. For a distressed seller, Chapter 11 provides a useful set of tools as it can provide a focused auction structure under Section 363, make short-term bridge financing available under a DIP credit facility or provide for a total restructuring of the capital and debt structure of the company through a pre-packaged or pre-negotiated plan.

Because of the uncertainties surrounding the distressed seller and the questionable value of the company's assets, it is likely that the sale will, if outside of Chapter 11, be consummated as an asset sale. If all or substantially all of the assets are being sold, then shareholder or member approval will be required under applicable corporate law. For a public company where the value of the assets is exceeded by the obligations of the company, the need to obtain shareholder approval where little if any value will go to the shareholders will likely result in bankruptcy filing since shareholder approval will be difficult if not impossible to obtain and that requirement can be avoided in the context of a Section 363 sale or plan confirmation.[26] Our primary focus here will be on asset transactions where shareholder votes are <u>not</u> required.[27]

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[25] As a practical matter, many times in today's economic environment, the distressed seller is current or relatively current with its trade creditors but in default with its RBL lender and noteholders. Since the buyer will not want to take the properties subject to the bank liens, asset sales coupled with negotiated releases from the banks are common.

[26] In connection with the confirmation of a Chapter 11 plan, if no value goes to the shareholders, the shareholders are deemed to have rejected the plan and their vote is not required. 11 U.S.C. § 1126(g). The only issue that will need to be addressed in connection with the protection of the shareholders' interest is the valuation issue and whether the purchase price represents the highest and best offer and is sufficient to pay senior classes in full.

[27] Thomas Bateman has prepared a comprehensive checklist for asset and stock natural resource acquisitions. Bateman, *Checklist for Resource Asset and Stock Acquisitions: Domestic and (Certain) Foreign Issues*, 47 Rocky Mtn. L. Inst. (7-1) (2001).

Whether the fiduciary duties flow to the shareholders or the creditors, the distressed/insolvent seller must structure the sale process in a manner calculated to maximize value of the assets being sold.[28] Thus, whether the assets being sold constitute all or substantially all of seller's assets or some lesser amount, the insolvent/distressed seller should actively market the assets in a manner that achieves the highest value for the assets.[29]

Given the necessity for the distressed seller to maximize value for the assets being sold, a competitive bid or auction process should be followed. If the seller is being pressured by its RBL lender to initiate the process or perhaps make a quick sale of the assets, the officers and directors nevertheless must require that the company undergo the appropriate process to maximize value and to avoid liability to the board of directors and officers of the company.[30] In any significant transaction, the board of the distressed seller would be well advised to retain an investment banker to manage the sales process. As pointed out previously, the board and the officers are presumptively protected by the business judgment rule by placing their reasonable

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[28] Some commentators have interpreted the *Gheewalla* decision as dispensing of a creditor's ability to make a direct claim against a director or officer while preserving the ability of the corporation to assert a derivative claim on behalf of the creditors as the injured constituency. *See* Baker Article at 858. Ms. Willett rejects this conclusion. *See* Willett Article at 1088.

[29] As will be seen below in discussion of fraudulent conveyance issues, the market test or auction effort is very important to the buyer as well.

[30] In *Bridgeport Holdings, Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings, Inc.*, 338 B.R. 548 (Bankr. Del. 2008), the Court denied the motion to dismiss by the Chapter 11 plan liquidating trustee against the chief restricting officer, board members and officers. The company hired a CRO at the behest (demand) of its banks and the CRO quickly decided to sell the company without undertaking a competitive bid process or hire investment bankers. The CRO pursued a quick sale opportunity identified by a board member and, within three weeks after the CRO's appointment, due diligence was completed and the sale was closed for $28 million. The sale price appeared to be substantially less than the fair market value of the company's operations. The day after the sale, the company shell was put into bankruptcy. The board members and officers were sued by the estate for breach of fiduciary duties and corporate waste in that the board members abdicated their fiduciary duties to the CRO, failed to supervise him and acquiesced to the sale for a grossly inadequate price. The buyer was sued by the estate as the recipient of an alleged fraudulent conveyance. The buyer rather quickly settled, paying an undisclosed sum to the estate, settling the fraudulent conveyance claims.

reliance in professionals retained by the company. Use of investment bankers to manage the sale is an important first step in meeting this standard and RBL lenders understand this.[31]

§11.05 Confidentiality Agreements

The next step in the seller's process after retention of the deal professionals (including competent counsel) is the preparation of a confidentiality agreement for distribution to and execution by interested parties.[32] The provisions of a confidentiality agreement can be hotly negotiated, thus delaying the process. For the distressed seller, transaction speed is important, so a reasonable confidentiality agreement structure is appropriate.

Among the issues that should be considered in preparation and negotiation of the confidentiality agreement are the following:

- Unilateral or mutual agreement: assuming that the transaction is a purchase and sale of properties and not a joint venture or farm-out arrangement, the buyer will not need to disclose much information to the seller other than its financial ability to perform. Nevertheless, potential deal terms and the fact that negotiations are taking place should be kept confidential.

- Seller should not provide buyer access to the data room without an executed confidentiality agreement.

- The confidentiality agreement should cover and be binding on attorneys, accountants and other service providers.

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[31] As the *Bridgeport* case illustrates, the retention of outside expertise is a necessary but not sufficient step. The retained professional must be competent and follow a procedure that is designed to maximize value not simply result in a quick sale.

[32] For comprehensive discussion of confidentiality agreements, see Kirman, *M & A and Private Equity Confidentiality Agreements Line By Line*, Aspatore Books (2008).

- The definition of what is confidential information is important and should cover data provided by seller and any analyses and projections developed by the recipient from such data.

- Is part of the data to be disclosed by the seller subject to its own confidentiality limitations between the seller and some other third-party?

- What are the permitted uses of the confidential information? Is the recipient able to only use the data with respect to the possible transaction? Contiguous property issues? AMI? Not to be used adversely against seller?

- What is the term of the confidentiality agreement?

- Return of the confidential information? All reports and analyses prepared by recipient?

- Use of data or information in possible subsequent auction in the bankruptcy court should the out of court sale effort fail? How does this impact stand-still agreement provision?

- Non-solicitation of seller's employees.

- Exclusivity provision – to be avoided by the distressed seller.

- Remedies – damages and injunctive relief.

Confidentiality agreements can be complicated agreements and the distressed seller needs to avoid the urge to prepare an overly one-sided agreement. Additionally, the real chance that

any transaction may ultimately be consummated through a bankruptcy sale or plan should impact negotiation of the issues. For the seller, the most important issue is to ensure that the process moves quickly and that the properties being sold are made available to a substantial number of buyers so that there is an effective and defendable market check.[33] The definitive term sheet and resulting agreement must be subject to higher and better offers with the buyer seeking a break-up fee that is not so outrageous as to chill the sale process.[34] In addition, the seller should ensure that the prospective purchasers agree to follow the procedures established by the company and not seek to circumvent or undermine the process. Employee non-solicitations are also important since the distressed seller will want to be able to retain its key employees during the process and have the employees available for possible hire by the purchaser. Key title and land people can greatly assist the seller in consummating the transaction and it may be appropriate for the distressed seller to implement an employee retention plan to keep the key people involved throughout the process. In a well-organized sale effort, the seller should structure the process so that all interested parties have access to the data and relevant personnel and that all parties can submit their bids accompanied by proof of financial ability and a mark-up of a proposed purchase and sale agreement or something close to a definitive term sheet.[35]

§11.06 Exclusivity or No-Shop Provisions

At some point in the auction process, one bidder should surface as the lead or winning bidder. Generally, the parties will enter into a non-binding letter of intent or agree upon a term sheet to memorialize the deal terms as the definitive term agreements are drafted.

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[33] While the prospect of competition can be disappointing to many buyers where the seller is a distressed company, the buyer should be interested in having a good record of the process and the resulting sale to the highest bidder as a well conducted auction can be dispositive of whether the seller received fair value for the assets sold.
[34] Many of these same protections are found in Section 363 sales conducted in Chapter 11 proceedings.
[35] The scenario described above reflects an orderly sales process where the trade creditors of the seller have not begun collection efforts which might derail the process and push the company into bankruptcy.

In a distress situation, the parties should resist efforts to have a detailed negotiated letter of intent. For the seller, time is of the essence, and the delay to the closing of a transaction can cause further deterioration in asset values. If the competition for the assets disappears, the leverage of the parties dramatically shifts in favor of the buyer and to the detriment of the seller. Seller, its counsel and any involved banker should do whatever it can to keep multiple interested buyers involved until there is a signed purchase agreement. For some period of time (one week to 30 days), the seller and buyer will want to finalize the definitive purchase agreement and associated sale mechanics. The buyer will want to use such period of time knowing that it can finalize the agreements without concern over the competing bids. In a normal transaction, the buyer will also seek a set period of time to consummate the sale after the agreements are finalized. The distressed seller should not grant such exclusive right to the buyer as it needs the ability to pursue higher and better offers that may be presented. A better offer may simply be one that is more likely to close.

The distressed or insolvent seller should not assume that it will automatically have the benefit of a fiduciary out while it negotiates the definitive documents. In a 2009 bench decision from the Delaware Court of Chancery, Vice Chancellor Laster enjoined the defendant seller from soliciting or entertaining any third-party offers during the term of the letter of intent. There was no "inherent" fiduciary out in the letter of intent and even though it was a non-binding letter of intent, it must mean something.[36] The seller should resist any "no-shop" and make the prospective purchasers understand that the financial distress of the seller requires and the process contemplates a competitive sale with multiple interested parties. However, if necessary, the "no-

[36] *Global Asset Capital, LLC v. Rubicon US REIT, Inc.*, No. 5071-VCL (Del. Ch. Nov. 16, 2009). The court also commented that with respect to the obligation to negotiate in good faith, "radio silence" is not operating in good faith.

shop" should be limited to finalizing the definitive agreements with the resulting transaction then shopped to other interested parties. The preferred method is to negotiate with multiple interested parties to enhance the seller's leverage and keep the purchaser from driving too tough a deal with respect to the binding agreements. A subsequent "go-shop" may make sense for a private equity buyer of a public company but is difficult in a distressed sale context.[37]

Fiduciary duties are implicated in two ways in a sale transaction involving a distressed seller. First, if the seller is selling all or substantially all of its assets, then such a change of control transaction requires that the seller retain the ability to consider superior offers.[38] In the non-auction context, there must be a body of "reliable evidence" available to the board supporting its sale decision as being in the best interest of the shareholders or creditors.[39] Where the seller is insolvent or in the zone of insolvency, a binding no-shop provision is similarly inappropriate as the seller needs to obtain the highest and best offer for the benefit of its creditors and other constituents and the purchaser wants to be able to establish that it paid fair value if the sale is subsequently attacked.

Once the seller believes, with the advice of its counsel and, more importantly, any investment banker or broker it has retained, that the proposed purchase offer represents the highest and best offer, the seller and the purchaser should finalize the purchase and sale agreement and attempt to close the transaction. In evaluating sale of the company or significant asset transactions, corporate boards frequently ask that the investment bankers assisting the

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[37] For a good discussion of "go-shop" structures and their effectiveness, see Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729 (2008).
[38] The board of directors has heightened duties under Delaware law in a change of control transaction. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). When a transaction is in the Revlon mode, the directors must obtain the best available value for the stockholders. However, courts have not required a full blown auction where a solvent company is being sold or selling all its assets; however, some market check on the adequacy of the consideration is required.
[39] *QVC Network v. Paramount Communications*, 635 A.2d 1245, 1267 (Del. Ch. 1993).

company with the sale provide the board with a "fairness opinion."[40] Such opinions, which are provided at a significant cost to the selling company, generally state that the transaction is "fair" from a financial point of view to the selling company. The fairness opinion does not state that the consideration paid represents the highest or best price or "reasonably equivalent value" for the assets transferred; it only states that the price obtained is in the range of fair values.[41] Nor does such an opinion state that the action taken by the board is the appropriate action for the company at that time. Nevertheless, such opinions are common in transactions involving the sale of a company or substantially all its assets.[42] While their overall value may be questioned, fairness opinions are useful in protecting the officers and directors in their exercise of the business judgment rule and satisfying the directors' duty of care.

§11.07 Risks to the Buyer Notwithstanding A Good Sale Process

In addition to risks relating to claims against the properties for unpaid services which should be discoverable during due diligence, a buyer of oil and gas properties from a troubled seller faces additional unexpected transaction risks. Any indemnity offered by the seller (absent a hold-back or escrow) is of questionable value given the insolvency of the seller. If the selling entity has been cash strapped for some period of time, it is likely that its field operations have suffered from lack of available capital. Drilling budgets will have been reduced and the prospective buyer should take care to ensure that properties and leases have been timely

[40] While fairness opinions are sometimes provided by entities specializing in business or asset valuations, they generally are given by the investment banking firm retained by the seller.
[41] See generally, Anil K. Makhija and Rajesh P. Narayanan, *Fairness Opinions in Mergers and Acquisitions*, Fisher College of Business WP 2007-03-018, October 14, 2007.
[42] The Delaware Supreme Court suggested that a board should use a fairness opinion in fulfilling its duty of care in a sale of a company. *Smith v. Van Gorkom*, 488 A.2d 858, Del. 1985. The *Van Gorkom* opinion helped create the cottage industry of providing fairness opinions in significant sale transactions much to the joy of many valuation or investment banking firms. Many question the real value of such opinions since the investment banking firm providing the opinion may well be the sell-side advisor whose "success fee" for a completed transaction greatly exceeds the fairness opinion fee. *See* Makhija and Narayanan at 10-11.

maintained, that the necessary leases have been held by production and that field operations have not suffered. On site due diligence becomes more important as does the review of production records.

In addition to the increased operational risks, the purchaser of the distressed seller's properties faces additional risks, such as successor liability and fraudulent conveyance risks which are each discussed below. However, before addressing those issues, it would be appropriate to focus briefly on some of the claims and liens that are likely to exist with respect to a financially troubled oil and gas producer.

The purchaser of assets from a distressed seller should ensure that its due diligence include searches in the following areas: (i) a lien search by a qualified land-person in all significant locations, with the search limited to the spacing and production units of the producing wells including up to date search of the applicable county and UCC searches, (ii) a review of the bank and trade debt situation, (iii) a title search; and (iv) a civil action search in applicable state and federal courts.[43]

From these searches and book and records of the seller, the purchaser should be able to determine which known obligations must be satisfied before the purchaser can acquire the properties free and clear of liens, claims and encumbrances. In addition to a recorded lien, a purchaser should consider, especially with respect to non-operated working interests, whether joint interest billings ("JIBs") due under the joint operating agreement ("JOA") have been paid. The operator can record the JOA (or a short form memorandum thereof) to perfect a lien and in any event, will have the contractual setoff and recoupment right against the non-operator

[43] If the seller has been thorough in its preparation of the data room, the searches noted should be included.

working interest owner under the JOA. In addition to lien claims of record, the purchaser should carefully review the books and records in an effort to determine the universe of other claims that may have not ripened to litigation or liens against the properties. If significant claims exist, the purchaser should not be content with paying the sale proceeds to the seller and expecting the seller to timely pay such claims. If the sale price is less than the secured debt, the bank will no doubt require direct payment of the purchase price against the delivery of the bank's lien releases; however, the purchaser should still insist that trade creditor claims that could ripen into lien claims be paid from the sales proceeds as the bank is the beneficiary of the process undertaken by the seller. [44] An escrow arrangement with a title company or third party escrow agent with detailed instructions can be used. The seller knows that, absent a sale, the RBL lender's remedy is either a complicated and slow foreclosure proceeding, followed by a subsequent sale of the properties or a costly and uncertain bankruptcy. The transaction and carrying costs to the lenders will be significant and the RBL lenders may well accept the reduced payment in an effort to obtain a more expedited sale and avoid lengthy foreclosure proceedings.[45] The going concern sale has significant benefits to the RBL lender in obtaining top value for the properties, retirement of its debt and the relatively quick exit from the credit.

One way to resolve unpaid trade claims is to use an escrow agent or title company to assist purchaser in establishing a mechanism to clear off all liens and claims against receipt of payment.[46] While significant up-front efforts are required to set up an escrow closing

[44] Oil and gas contractors' lien claims arise when work is first performed on the property but no lien affidavit needs to be recorded until after the date of last work, assuming continuous work. As such, it is difficult to determine the priority of operator liens as against a secured bank. For the purchaser outside of bankruptcy, this does not really matter as all such liens must to resolved to get clean title.

[45] Obtaining approval of any write-off in a consensual transaction will likely require a showing to the bank that the proposed purchase price is the result of a robust sales effort.

[46] *See* Hovey Kemp and Christopher L. Richardson, *Acquiring Producing Oil and Gas Properties from a Financially Distressed Seller*, 58 University of Colorado Law Review 631-655, 1987.

mechanism, outside of bankruptcy, it may be the only mechanism available to the parties to close the transactions and have the claims paid. In addition to receiving release of liens on the properties, the purchaser should also obtain stipulations for dismissal of lien foreclosures and other civil actions that could affect the properties as well as any satisfaction of judgments that might be required. Finally, general releases, which cover the seller and the purchaser, should be obtained from any creditors receiving payments at closing.[47]

Where banks previously might have been willing to restructure their credit relationship with the borrower, the bank's own regulatory pressures and diminished capital have altered their approach to troubled credits. Now, many banks simply want out and with the large number of syndicated loans, it is very likely that even if the lead bank and some of the participants were inclined to support a traditional restructuring of the credit, others within the lending syndicate may well have decided that they must exit the credit. If their vote is necessary to achieve the "required lender" consent for material amendments to the credit agreement, a forced sale of the properties may be required.[48]

Once the company has decided to sell its assets or portions thereof, the structure of the sale should be considered. If the seller is seeking to sell all its assets, it will likely consider a stock sale as opposed to an asset sale though shareholder approval and contingent liabilities could prove problematic. While stock sales have some advantages such as avoidance of third-party approvals, governmental filing requirements and preferential purchase rights,[49] in situations where the seller is financially distressed or insolvent, the sale (if consummated outside of

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[47] Since today's distressed seller is more frequently a company that is forced to sell its properties to retire defaulted bank debt rather than its inability to pay its trade debt, the escrow closing is less likely to be required.
[48] While the terms of each syndicated credit agreement vary, extending the payment terms or the maturity date under a credit agreement frequently requires the consent of <u>all</u> the participant banks.
[49] *See* Boigon and Hilton at 8-13.

Chapter 11) will likely be consummated as an asset transaction. The corporate shell will likely have too many contingent and "unknown" liabilities that the likely buyer is simply and correctly unwilling to assume.

There are a variety of reasons for this. First, historically, oil and gas transactions are generally consummated as asset sales. Boigon and Hilton have produced a useful summary of the development of thought with respect to stock sales versus asset sales in oil and gas transactions, drawing on the excellent work of practitioners in the field.[50] The possible insolvency of the seller changes the analysis and will cause purchasers to avoid a stock acquisition as the purchaser will want to avoid liabilities of the selling company and, perhaps more importantly, the stock will likely not have any value after payment of creditor claims. The purchaser will only be interested in the identified properties and contracts being sold and will likely not have any interest in non-production assets such as building leases and other overhead obligations associated with the corporate shell. And, the purchaser will obviously want assurance that such assets be sold and transferred free and clear of liens, claims and encumbrances or that it assume the liabilities associated with the acquired properties in exchange for a reduction in the purchase price payable to the seller.

The likely selection of an asset transaction, coupled with the distressed seller's desire to maximize value and the purchaser's desire to acquire the properties free and clear of liens and claims and insulated from subsequent attack, has led to the more frequent use of an auction structure in the context of a Section 363 sale under the Bankruptcy Code. However, substantially the same result can be achieved through a seller-established sale process, followed by an escrow mechanism for the closing, thus avoiding the time delays, unexpected changes and

[50] Boigon and Hilton, *supra* at 3-5.

increased costs of a Chapter 11 proceeding.[51] As noted above, many of the distressed sellers in today's market are operationally sound but out of compliance with loan covenants and excessive secured and bondholder debt as opposed to companies with excessive trade creditor claims and other field problems.[52] Asset dispositions will frequently not resolve the financial distress confronting these larger companies and a bankruptcy filing will be required. However, many financially troubled companies still pursue asset sales.

§11.08 Environmental Claims and Royalty and Tax Claims

While a careful escrow-agent controlled closing or bankruptcy sanctioned sale can be effective to transfer free and clear title to oil and gas properties to the careful (and meticulous) purchaser, certain claims may still survive. Indeed, some of these claims will survive a Section 363 sale or confirmed reorganization plan. Care needs to be taken by the purchaser with respect to environmental, royalty and tax claims.[53]

In many oil and gas producing states, royalty interests are considered real property.[54] Notwithstanding their status as interests in real property, unpaid royalty claims are unsecured claims generally. For royalty claims, the general rule is that a failure to pay landowner royalties

[51] *See* Kemp and Richardson, *supra*. The increased use of Section 363 sales for asset transactions will likely continue as purchasers become more comfortable with the Section 363 process and practitioners recommend the process as an effective way to protect the seller and the purchaser from many of the risks discussed in this paper. The sale order provides the purchaser with one very important attribute lacking from an effective and carefully done out of court structured sale -- peace of mind. But remember, as Frank Borman the former astronaut and CEO of Delta Airlines once said: "Capitalism without bankruptcy is like Christianity without hell."

[52] While this is generally an accurate statement, most purchasers from distressed sellers will tell you that because of staff cut-backs by the sellers, field operations and relevant operational records are not up to industry standards.

[53] Boigon and Hilton at 14; David G. Ebner, *Advanced Purchase Agreement Issues*, Paper 5, RMMLF, Special Institute on Oil and Gas Acquisitions (November 1995) at 5-19, 20 (hereinafter "Ebner").

[54] See *Humble Oil and Ref. Co. v. West,* 508 S.W.2d 812 (Tex. 1974); *Denver Joint Stock Land Bank v. Dixon,* 57 Wyo. 1942); Colo. Rev. Stat. §38-30-107.5; *La Laguna Ranch Co. v. Dodge,* 18 Cal.2d 132 (Cal. 1941). Louisiana is not so simple as royalty can be real or personal property depending on a variety of factors. LSA Code of Civil Procedure, Art. 3364; Act 205 of 1938; Act 6 (2d Ex.Sess.) of 1950, now LSA-R.S. 9:1105. See generally, Deborah D. Williamson, Meghan E. Bishop, *When Gushers Go Dry, The Essentials of Oil & Gas Bankruptcy,* at 78 – 85, (American Bankruptcy Institute 2012

does not result in a termination of the lease.[55] While they do exist and should be looked for in due diligence, lease provisions permitting cancellation of the lease for non-payment of royalties are rare.[56] However, the federal government has taken an aggressive position with respect to unpaid royalties on federal leases and a purchaser needs to carefully determine the status of federal royalties to avoid a loss of the property.[57]

In the past few years, there has been a substantial increase in litigation relating to unpaid landowner royalties. In part, this has arisen because of state statutes like the Wyoming Royalty Payment Act which has expanded the liability of assignees with respect to unpaid landowner royalties.[58] In part, this is because "the oil and gas lease enjoys the mixed blessings of many judicial views on the meaning of many royalty clause variations found in oil and gas leases and lease assignments."[59] The changes in the marketing methodologies for the oil and gas production have also impacted the calculation of taxes due with respect to producing properties, further complicating the analysis.[60]

With respect to the assignee of an oil and gas lease, by virtue of the privity of estate, the assignee (purchaser of the property) may be liable to the lessor (landowner) for breach of covenants in the lease.[61] However, a "lessee's assignee is not liable for breach of covenant occurring before the assignment of the lease to him."[62] Because of what Professor Pierce has

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[55] Ebner at 5-20; Boigon and Hilton at 16.

[56] While rare, such provisions create a fee simple determinable estate and are generally enforceable in bankruptcy notwithstanding. 11 U.S.C. §365(e)(1). See*,* *Trigg v. United States*, 630 F.2d 1370, 1374 (10th Cir. 1980).

[57] *See* 43 C.F.R. § 3108.3(b) (2005) (lease cancellation as a remedy); Boigon and Hilton at 16.

[58] *Wyo. Stat. Ann.* §§ 30-5-301, *et seq.*

[59] David E. Pierce, *Judicial Interpretations of Royalty Obligations and the Resulting Drafting Lessons*, Paper 7 RMMLF, Special Institute on Private Oil and Gas Royalties: The Latest Trends in Litigation (December 2008).

[60] See generally, Danielson and Niebrugge, *Evaluating the Purchase and Sale Agreement in Light of Potential Royalty and Tax Claims*, Paper 12, RMMLF, Special Institute on Private Oil and Gas Royalties: The Latest Trends in Litigation (December 2008) (hereinafter "Danielson and Niebrugge").

[61] Danielson and Niebrugge at 4.

[62] 2 William & Meyers, *Oil and Gas Law*, § 403.3 at 269, cited in Danielson and Niebrugge at fn. 15.

labeled the “advance novation clause” found in many oil and gas leases, the seller of an oil and gas lease is only liable for acts occurring during its ownership of the lease; conversely, the purchaser is only liable for breaches occurring during its ownership.[63]

However, in valuing the properties being sold, even though the purchaser does not have direct liability for breaches of covenants occurring prior to its ownership of the lease, the “stated net revenue interest assumes the current manner in which the seller is paying such royalties and taxes complies with the terms of its contracts and is in compliance with state law.”[64] If the assumption turns out to be incorrect, the discrepancy, if discovered during the due diligence period prior to closing, should enable the buyer to adjust the purchase price in the title adjustment mechanism in the purchase agreement or, if truly a significant adjustment, seek to terminate the acquisition. If discovered after closing, then perhaps the purchase and sale agreement indemnity, if any, may protect the buyer. Obviously, with the distressed seller, absent escrowed funds or a holdback, the indemnity may well be illusory.

§11.09 Issues Relating to Gathering Agreements and the Sale of Assets

Many E&P companies have entered into contracts with midstream companies to gather, transport and process their oil and gas production. To assist the pipeline companies to pay to build out the pipeline systems, the E&P companies frequently dedicate all the oil and gas produced from the properties in the involved acreage to the mid-stream companies, many times entering into minimum volume commitments at set prices to assist the midstream company in financing the buildout of the gathering system. Minimum payments may be required even if production falls below certain specified volumes and market price levels. For distressed E&P

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[63] Danielson and Niebrugge at 5.
[64] *Id*. at 6.

companies, a bankruptcy filing may offer the E&P company the ability to reject the costly gathering agreement as an executory agreement under Section 365 of the Bankruptcy Code, saving the debtors millions of dollars in over market gathering fees. This was the strategy of Sabine Oil & Gas Co. ("Sabine") in its Chapter 11 proceeding in the Southern District of New York. Sabine sought to reject two gathering[65] and the gathering companies objected, arguing that the agreements in question could not be rejected as they created covenants that ran with the land as real covenants or equitable servitudes. In a decision that for procedural reasons was non-binding, the Court permitted the rejection of both agreements and held in a non-binding opinion, that under Texas law, the agreements did not "run with the land" nor did they "touch and concern" the land under applicable state law.[66] This tactic is being tried in a number of other significant bankruptcy cases.[67]

For out of court sales efforts, the selling E&P company does not have a similar capability. If the company sells the underlying acreage subject to the gathering agreements without assigning the agreement (which the buyer will very likely not want), then the selling company will be saddled with the residual liability and the buyer will need to renegotiate a gathering agreement. If the gathering agreement has dedication language to the identified acreage and the agreement (or a short-form memorandum thereof) is recorded, then the buyer takes subject to the dedication as there will be priority of estate. Additionally, sophisticated

[65] The rejection of an executory contract is deemed a breach of the agreement and the counterparty to the agreement can file an unsecured claim for damages under the agreement. See §§ 502(g) and 365(g) of the Bankruptcy Code. The E&P debtor will then no doubt attempt to renegotiate better terms more reflective of the current market with the midstream company.

[66] *In re Sabine Oil & Gas Corp.,* (No. 15-11835 SCC) (Bankr. S.D.N.Y. March 8, 2016, ECF No.872). A subsequent adversary proceeding adopting this result is currently on appeal. The law on this issue is by no means settled.

[67] *In re Quicksilver Resources, Inc.,* No. 15-10585 (LSS) (Bankr. D.Del. March 17, 2015); *In re Magnum Hunter Resources Corp.*, No. 15-12533 (KG) (Bankr. D. Del. December 15, 2015); *In re Triangle USA Petroleum Corp.*, No. 16-11566 (MFW) (Bankr. D. Del. July 29, 2016); and *In re Emerald Oil, Inc.*, No. 16-10704 (KG) (Bankr. D. Del. March 22, 2016).

midstream companies will include provisions in their gathering agreements that the conveyance of the properties subject to the agreement without an assignment of the agreement is a default under the gathering agreement. Most likely, the thoughtful buyer will attempt to negotiate a new gathering as a condition to the sale, with the tacit understanding amount the parties that if a consensual amended agreement cannot be reached, the selling E&P company will likely be required to file bankruptcy and then seek to reject the gathering agreement in the context of a Section 363 sale. The law is not settled on the issue by any means.[68]

§11.10 Tax Payment Issues

Payment of production or ad valorem taxes varies on a state-by-state basis and can produce difficult allocation issues in any transaction. Conceptually, the buyer should be responsible for taxes attributable to production from and after the effective time, with the seller responsible for amounts due relating to production occurring prior the effective. However, the timing of when the state taxes become due complicates the matter.

In Colorado, the operator must report to the county assessor by April 15 of each year the volume of oil and gas sold from the property during the prior year, along with the sales price.[69] The actual tax bill comes out late that year and is due by April 30 of the following year – so in essence, the taxes are assessed two years in arrears.[70] While the operator may be responsible for withholding the estimated amount of the tax depending on the operator's history of timely payment of amounts due, that is not always the case. Ultimately, the owner of the minerals, not

[68] Contract assignment issues can be difficult. In December, 2015, the Wyoming Supreme Court issued its Pennaco decision, holding that parties to a contract, such as a surface use agreement, remain liable for the obligations under that agreement - even when the agreement and underlying assets have been sold and assigned to a third party unless the agreement contains express language releasing and discharging the original party upon the assignment. *Pennaco Energy, Inc. v. KD CO, LLC*, 363 P.3d 18 (Wy. Sup. Crt. 2015).

[69] Colo. Rev. Stat. § 39-7-101 (1994); Ebner, *Advanced Purchase Agreement Issues*, Paper 5, RMMLF, Special Institute on Oil and Gas Acquisitions (November 1995) at 5-23-28.

[70] Colo. Rev. Stat. § 39-5-129 (1994); Ebner at 5-25; Danielson and Niebrugge at 12-6.

the operator, is responsible for payment of taxes due. Significantly, while the purchaser of the properties is not directly responsible for taxes due for periods prior to closing, the acquired properties may be subject to state liens for unpaid taxes and the liens can attach against future production.[71]

As has been pointed out, the timing issue is further complicated because the taxes are calculated based on the value of the production at the time of the sale. If the funds estimating the amount due were not withheld and the price of oil and gas then collapses, the future production will not be sufficient to pay amounts that will become due from the property for the prior periods.[72] If amounts have been set aside, the seller should be required to turn them over to the purchaser for payment when the amounts become due in the future.

As with many of the issues involving a distressed seller of oil and gas properties, the purchaser needs to take care that it has carefully investigated the status of ad valorem/production taxes. The best way to address the issue for the purchaser is to estimate the amount that will become due for production occurring prior to closing based on the seller's production records and then have the purchaser assume this liability for the pre-closing period and deduct the amounts so assumed against the purchase price. The purchaser should also obtain copies of all relevant records that may be required in the future to defend the calculation of the taxes that may become due. If seller has escrowed amounts due, those funds should be transferred to the purchaser and the amount of the reduction recalculated. Presumably, if there are other working interest owners for these properties, their proportionate share of any escrow for the taxes will be

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[71] Danielson and Niebrugge, *Id.*

[72] Milam Randolph Pharo, *The Purchase and Sale Agreement – The Buyer's View*, Paper 3, Oil and Gas Agreements: Sales and Financings (May 2006) at 3-13.

transferred to the purchaser. Given the relevant state agency's ability to record a lien against the properties for unpaid taxes relating to prior periods, this issue requires careful attention.

Another issue that can be problematic when purchasing operating properties from a seller where the seller is also the operator, is the transfer of the JOA and whether the purchaser will become the operator. With a distressed seller, it is likely that there will be defaults under the JOA, some monetary and some non-monetary.[73] If it is a poorly operated seller, it is not uncommon to have deficient documentation at the JOA level, especially where the owner (seller) may have transferred working interests to service providers in lieu of cash payments. Many times the seller will have difficulty locating a fully executed copy of the JOA. If the operator is the seller, absent the appointment of the purchaser as the operator under the JOA, an operator selling its working interest is deemed to have resigned once it no longer owns an interest in the contract area. The successor operator is selected by the affirmative vote of two or more parties owning a majority interest in the contract area at the time such successor operator is selected. While there are situations where an operator has succeeded in assigning its right to operate, such situations, outside of bankruptcy, are the exceptions and not the rule.[74] The purchaser should be willing to work with the existing working interest owners in the properties being transferred in an effort to obtain the support of the other parties for the purchaser's designation as operator.[75] The other working interest owners will likely want to know the purchaser's immediate intentions

[73] *See* Ernest E. Smith and John S. Lowe, *The Operator: Liability to Non-Operators, Resignation, Removal and Selection of a Successor*, Paper 2, RMMLF, Special Institute on Oil and Gas Agreements: Joint Operations (March 2008) (hereinafter, "Smith & Lowe").

[74] Smith & Lowe at 2-14. The JOA is an executory contract under Section 365 of the Bankruptcy Code which can be assumed and assigned by the debtor operator provided that all defaults are cured and the assignee can provide adequate assurance of future performance.

[75] The purchaser's economic evaluation of the acquisition may well include its assumption of operations under the application JOA(s). If the seller has been in default under its obligations, the purchaser should not take for granted its ability to assume operations.

in connection with the development of the properties, especially if the other working interest owners believe the past owner had failed to live up to its obligations in that regard.

§11.11 Environmental Claims

Even in the context of a bankruptcy approved sale of oil and gas properties there is no effective way for a purchaser to insulate itself from environmental liabilities with respect to the acquired properties themselves. The liabilities, even if caused by the predecessor owner, in essence, run with the land and the purchaser will be held responsible under applicable law for the cleanup of the acquired property[76]. If the acquired property is subject to a leaking underground storage tank for example, the obligation for the owner to remediate that situation on the acquired property will survive bankruptcy. If a hazardous plume had migrated and continues to migrate down gradient to adjacent property not owned by the seller and thus not sold to the purchaser, the adjacent land owner would have a claim against the seller for the clean-up of the property because of the continued migration of the hazardous material. However, assuming there was no further discharge from the tank or migration of the hazardous material to the adjacent property, the claim of the adjacent landowner could be discharged in bankruptcy because there was no continued pollution to the adjacent property. Similarly, the purchaser of the property could acquire the property in an asset transaction without assuming the prior liability so long as there was no additional release of a hazardous substance from the acquired properties.

Where the seller may retain the economic responsibility to remediate environmental defects for properties being sold (either through an express indemnity or otherwise) under a standard purchase and sale agreement, such a mechanism should be avoided for obvious reasons

[76] It is standard practice in many circuits in the United States for the U.S. Trustee to insist that in any Section 363 sale order or confirmation order there be included a paragraph expressly stating that the purchaser remains responsible for any environmental liabilities existing on or emanating from the acquired properties.

where the seller is financially distressed.[77] As a general matter, where the seller is financially distressed, the thoughtful purchaser will take steps to quantify the risk of environmental and other claims that will or may survive closing and, as with royalties and taxes, assume such liabilities while reducing the purchase price for the liabilities assumed. It is certainly preferable for the buyer to have control over resolution of the issues rather than an insolvent seller.

Careful environmental due diligence is especially important when a seller is financially distressed caused by diminished revenues as the lack of cash flow will likely have contributed to a deterioration in the quality of field operations and lax environmental compliance. The purchaser should take care to review all environmental issues on the properties to be acquired, not limiting their review to just the most valuable properties. As has been pointed out by experience and writers in the field, the cost of environmental compliance is not related to the value of the property and frequently, the lowest value property may be subject to the costliest remediation efforts.[78] The environmental review needs to be completed and, if the buyer cannot exclude the property under the purchase agreement, then the purchaser should make sure that the value of the environmental defect not be limited to the allocated value of the property and the deduction for the clean-up of the property should be taken up front.[79]

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[77] *See* Boyd A. Bryan, *Environmental Due Diligence in Mineral Property Transactions: Emerging Risks, Requirements and Strategies*, 51 Rocky Mtn. Min. L. Inst. 24-1 (2005); Boigon and Hilton at 14 (fn. 99).

[78] David E. Pierce, *Structuring Routine Oil and Gas Transactions to Minimize Environmental Liability*, 33 Washburn L.J. 76, 145 (1993); Boigon and Hilton at 15.

[79] If the seller is divesting itself of all its properties in an “exit” transaction, it will likely resist the standard provision where the purchaser can exclude certain properties if the costs to remediate exceed the value property.

§11.12 Successor Liability Issues

It is well known that, with few exceptions, a purchaser in an asset transaction acquires the assets without being forced to assume excluded debts and liabilities of the seller.[80] In addition to those liabilities that run with the land and can become the liability of the purchaser even if not expressly assumed under the asset purchase agreement, there are situations where the purchaser in an asset sale is deemed the "successor entity" and thus responsible for the debts and liabilities of the predecessor, selling entity.

The four exceptions that are generally recognized to the rule of non-liability for the purchaser in an asset purchase agreement are:[81]

1. A situation where the purchaser expressly or implicitly has agreed to assume some or all of the debts and liabilities of the seller. Careful drafting can usually avoid this risk.

2. A situation where the transaction is found to have been a consolidation or merger of the parties – the so-called "de facto" merger. The essential issue here is whether there is a continuity of shareholders (i.e., the purchaser pays for the acquisition with shares of the purchasing corporation) followed by a dissolution of the selling corporation.

3. A situation where the purchasing corporation is a mere continuation of the selling corporation. The focus of the analysis is whether there is a continuity of ownership or corporate structure (name, location, employees) among the seller and purchaser.

4. Finally, there is the situation where the entity enters into transaction with fraudulent intent to avoid liability for its debts.

Successor liability issues have not been prevalent in oil and gas acquisitions as there are other, more direct ways in which the common sorts of claims that exist with respect to oil and gas properties or operations can be pursued. As noted previously, most oil and gas producing

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[80] See generally, David W. Pollack, *Successor Liability in Asset Acquisitions, PLI Acquiring or Selling the Privately Held Company* 2003; 1376 PLI/Corp. 255).
[81] *Id.* at 272-273.

states have statutory liens for unpaid services providers to oil and gas companies. Mechanics and materialman's liens attach to the properties in question and the lien holder has a direct way to obtain payment in the context of a sale. Other working interest holders' rights are generally protected under the joint operating agreement, which itself can impose liens on the various working interests under a lease for amounts due among the interest owners.[82]

One area where a purchaser (assignee) of oil and gas properties must be careful is with respect to plugging and abandoning liability relating to idle or deserted wells on leases acquired by the purchaser. The issues with respect to non-producing and abandoned wells are complicated and each state generally has its own rules at the oil and gas commission or equivalent level that attempt to regulate the issues and allocate financial responsibility.[83] As a general rule, the operator is responsible for plugging deserted wells.[84] If the operator fails to pay, then some states allocate secondary responsibility on non-operating working interest owners.[85]

The careful purchaser should not assume that where a lease is assigned with both operating wells and deserted wells that the assignee/purchaser is protected against liability for plugging responsibility with respect to the deserted wells. If the seller is insolvent, the applicable regulatory agency will likely seek a deep pocket for the deserted wells and owners of

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[82] *See generally*, Milam Randolph Pharo and Constance L. Rogers, *Liabilities of the Parties to a Model Form Joint Operating Agreement: Who Is Responsible For What*, Paper 5, RMMLF, Special Institute on Oil and Gas Agreements: Joint Operations (December 2007)(hereinafter, "Pharo & Rogers").
[83] *See generally*, Alan V. Hager and Kevin L. Shaw, *Idle and Deserted Wells: Who Plugs and Who Pays?*, 45 Rocky Mt. Min. L. Inst. Paper 12 (1999) (hereinafter, "Hager & Shaw").
[84] Hager & Shaw at 12-7.
[85] *Id*. at 12-8. Some of the state statutes seem to use owner and operator almost interchangeably, further complicating the issue.

working interests may well find themselves as secondarily responsible parties.[86] In some situations, even where the statute makes only the owner or operator liable for plugging abandoned wells, state agencies have gone after prior owners in their quest for a deep pocket to cover the cost of plugging orphaned wells.[87] Again, the best practice for the careful purchaser will be to perform exhaustive due diligence and factor into the purchase price a deduction for the risk of the plugging and abandonment liability. However, the purchaser should be careful on expressly assuming a liability for the orphaned wells in a manner that would create liability where none existed previously.

As has been noted in previous RMMLF papers, careful due diligence cannot always protect the purchase with respect to environmental claims, plugging responsibilities or the calculation of taxes and royalties due with respect to properties being acquired.[88] Even with a solvent seller, the purchaser is not necessarily protected by the representations and warranties.[89] However, with the insolvent or distressed seller, an unsecured indemnity obligation may well be worthless so the careful purchaser should to the greatest extent possible, quantify the risks and try to protect itself up front. Obviously, in a competitive auction this may place the careful purchaser at a disadvantage.[90]

[86] Generally, operators are required to post some form of security for their plugging obligations. The purchaser should investigate the status of the posted security and work with the regulatory authorities towards a resolution of the issues and financial responsibility of the parties prior to closing. If timing does not permit this, the purchaser should insist on a holdback until the issue can be resolved.
[87] Hager & Shaw at 12-21.
[88] Danielson and Niebrugge at 12-9, 12-10.
[89] *Id*. at 12-12 through 12-18. *See also*, Judith M. Matlock, *Going Forward Methodologies in Class Action Lawsuits, Private Oil and Gas Royalties*, Paper 9, RMMLF, Private Oil & Gas Royalties: The Latest Trends in Litigation (December 2008).
[90] Someone once said that the best deal can sometimes be the deal that does not get done. Experience continues to demonstrate that motivated purchasers have a tough time walking from troubled transactions.

§11.13 Fraudulent Conveyance Risks for the Purchaser

A final but significant risk that needs to be considered by the purchaser of oil and gas assets from a distressed seller is the risk that the acquisition is subsequently attacked by creditors or a bankruptcy trustee as a fraudulent transfer. A carefully structured sale outside of bankruptcy, with an eye on the issues noted herein as well as the use of the sale proceeds, can go a long way to protect the purchaser.

The post-closing risk to a purchaser with respect to fraudulent transfer claims generally arises upon the completion of the sale when the seller is unable to continue its business or successfully wind-down the company and a voluntary or involuntary bankruptcy is commenced.[91] The debtor (or court appointed trustee) is then able to review transactions within the two years prior to the filing (or longer under state fraudulent conveyance laws) under applicable fraudulent conveyance laws and perhaps seek to set aside the transfer. Obviously, if the completed sale was structured so as to ensure payment of the seller's creditors with the sale proceeds, the risks of a subsequent bankruptcy of the seller are reduced.

A fraudulent conveyance consists of a transfer of a debtor's interests in property made voluntarily or involuntarily within two years before the debtor files for bankruptcy.[92] The debtor or trustee can set aside the transfer and recover the property transferred for the benefit of the creditors.[93] While transfers made with the actual intent to hinder, delay or defraud creditors can

[91] An involuntary petition can be filed by three unsecured creditors whose non-contingent, bona-fide claims total $15,775, along with the allegation that the debtor is not paying its debts as they become due. 11 U.S.C. § 303(b) and (h).
[92] The discussion here will focus on the analysis of fraudulent conveyance actions brought under Section 548 of the Bankruptcy Code. The debtor or trustee can also bring claims under state fraudulent conveyance statutes which are available to the debtor or trustee pursuant to the "strong-arm powers" of the debtor which enables the debtor to bring certain avoidance actions under applicable state law. State fraudulent conveyance laws are very similar to Section 548 provisions though the look back period for claims under state fraudulent conveyance statutes are generally longer and can extend back up to six years under the New York statute and up to ten years in Alabama.
[93] 11 U.S.C. § 550(a).

be set aside,[94] our concern here rests more on the constructive fraud provisions of the statute. The constructive fraud provisions do not rely on the intent of the parties but rather on whether, in its simplest form, the debtor received "reasonably equivalent value" for the property transferred <u>and</u> whether the debtor was insolvent at the time of the transfer or was rendered insolvent by the transfer or the obligation incurred.[95]

With respect to actual fraudulent conveyance claims, it is the intent of the <u>seller</u> not the purchaser that is relevant. Generally, intent is inferred from the circumstances and the following are some of the issues that the courts have considered under Section 548(a)(1):

- was there a special relationship between the debtor and the purchaser;
- did the debtor retain any right to control the property and otherwise continue to enjoy its benefits post-closing;
- was the debtor insolvent or rendered insolvent by the transfer or the obligation incurred;
- were the assets transferred substantially all the assets of the seller; or
- whether the debtor was sued or threatened with litigation prior to the transfers.[96]

While not a total defense to a claim under Section 548(a)(1)(A), the receipt by the debtor (seller) of reasonably equivalent value can be helpful in rebutting the presumption of fraud.[97]

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[94] 11 U.S.C. § 548(a)(i)(A).
[95] 11 U.S.C. § 548(b).
[96] *See* 5 COLLIER ON BANKRUPTCY § 548.04[2][b][A]. (Alan N. Resnick & Henry J. Sommers, eds. 15th ed. rev.).
[97] 5 COLLIERS at § 548.04[3].

For claims under the constructive fraud provision of Section 548, both the intent and good faith of the parties are irrelevant. What is important is:

- did the debtor/seller receive less than the reasonably equivalent value for the transfer of the properties,[98] and

- at the time of the transfer, was the debtor/seller insolvent or rendered insolvent by the transfer,[99] or

- at the time of the transfer, was the debtor engaged in business or about to engage in business for which the remaining capital of the business was unreasonably small,[100] or

- at the time of the transfer, did the debtor/seller intend to incur debts that would be beyond the debtor's ability for pay.[101]

Our focus here will be on "reasonably equivalent value" and the solvency of the seller at the time of the transfer.

Determination of whether the debtor/seller received reasonably equivalent value requires a court to consider all the circumstances of the transaction to determine if the seller received fair market value for the property transferred. For our purposes, the issue becomes did the distressed seller obtain reasonably equivalent value for the oil and gas assets transferred to the purchaser.

[98] 11 U.S.C. § 548(a)(1)(B)(i).
[99] 11 U.S.C. § 548(a)(1)(B)(ii)(I).
[100] 11 U.S.C. § 548(a)(1)(B)(ii)(II).
[101] 11 U.S.C. § 548(a)(1)(B)(ii)(III).

Such determinations are largely questions of fact based on evidence of all the circumstances surrounding the transaction.[102]

The sale process undertaken by the distressed seller will be critical in the factual analysis of whether the debtor/seller received fair value. If the seller has fully shopped the properties and used an investment banker or broker knowledgeable about the industry and of the likely interested parties to set up and manage the process,[103] the purchaser, while perhaps not excited about the auction aspect of the transaction, should take comfort that there will be a strong record supporting the purchase price obtained as reflecting the fair, market value of the assets. The conundrum for the purchaser in a distressed acquisition is the lower the price, the greater the risk.

Additionally, if a banker is engaged, the seller and the purchaser should require that the banker delivers a fairness opinion with respect to the transaction and the consideration received. While the fairness opinion is not dispositive of the reasonably equivalent value issue, it does, when coupled with a strong factual showing of the detailed sale/auction process undertaken by the seller, provide support that the purchaser paid reasonably equivalent value or fair market value for the assets at the time of the sale. The contemporaneous record of the sale efforts and the delivered fairness opinion will provide protection against subsequent attacks to the transaction. While protecting the purchaser, the process at the same time protects the officers and board members of the seller with respect to their fiduciary duties to their particular constituents.

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[102] *See generally* 5 COLLIERS at 548.05[1][b] and the cases cited therein.

[103] While a seller could set up the sales process and contact the likely interested parties in an effort to maximize value, the use of a third-party expert is more likely to withstand a subsequent attack in a bankruptcy proceeding.

The other component that must be established by the debtor or trustee to set aside a prior transfer of property is whether, at the time of the transfer was the debtor/seller insolvent or was rendered insolvent by the transfer or the obligation incurred. Under the Bankruptcy Code, insolvency is in essence a balance sheet test – does the sum of an entity's debts exceed the value of its assets, at a fair valuation, exclusive of property transferred with the actual intent to hinder, delay or defraud creditors.[104] If the debtor/seller is a public company and the debtor's stock traded at the time of the sale for a positive value, the debtor/seller is presumed solvent.[105]

If the acquisition by the purchaser is a leveraged acquisition such that the properties being acquired are going to serve as collateral for a loan that will be taken out by the purchaser to pay the purchase price, the lender may require that the purchaser obtain a solvency opinion. This opinion does not address the solvency of the seller at the time of the sale, but rather is an opinion that the purchaser is solvent post-acquisition. There is usually a three-step solvency analysis undertaken to determine whether:

- the fair market value of the purchaser's assets exceeds its identified and contingent liabilities;
- post-closing, the purchaser would be able to pay its debts as they mature; and
- post-closing, the purchaser had sufficient capital to operate its business.

The solvency opinion is for the benefit of the purchaser's lender in the event the purchaser subsequently fails and the liens granted to the secured lender are set aside as

[104] 11 U.S.C. § 101(32(A). *See generally*, 5 COLLIER at 548.05[1][A].
[105] *Iridium Operating LLC v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 344 (Bankr. S.D.N.Y. 2007).

fraudulent conveyances.[106] However, to the dismay of lenders throughout the country, the efficacy of solvency opinions has come under attack. On October 30, 2009, the Bankruptcy Court for the Southern District of Florida issued a 182 page opinion setting aside obligations incurred and liens granted by subsidiaries of a parent entity in connection with a 2007 loan transaction for the now-bankrupt homebuilder, TOUSA. While the opinion is a careful and thoughtful analysis of many issues relating to fraudulent transfers, its rejection of the solvency opinion tendered by Alix Partners as inadequate was noteworthy.[107]

From the purchaser's perspective, the fraudulent conveyance risk can be managed by a properly structure transaction where the process leading up to the sale evidences a strong market check for the value of the properties and the purchaser takes care that the trade creditors of the seller are paid. The secured lender, even if paid at a discount, will have to release its liens on the assets and will be consenting to the payment and the release. As such, the secured lender will not be the source of a subsequent attack on the sale. However, if the trade debt is not paid, they can create a variety of problems with respect to their ability to place liens on the properties, initiate creditor fraudulent conveyance claims or even join together and commence an involuntary bankruptcy which will put the purchaser and the properties at risk.

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[106] This really is not an issue for a distressed seller. However, a solvent seller that sells its assets in a highly-leveraged transaction should be concerned. If the highly leveraged acquisition subsequently fails because of a collapse in oil and gas prices, the failed LBO can be attacked as a fraudulent conveyance and the shareholders of the seller can be sued. The attack on failed LBO under a fraudulent conveyance theory got its start from the *Gleneagles* case in 1983. *United States v. Gleneagles Inv. Co.*, 565 F. Supp. 556 (M.D. Pa. 1983), *aff'd sub non United States v. Tabor Realty Corp.*, 803 F.2d 1288 (3rd Civ. 1986), *cert. denied*, 483 U.S. 1005 (1987).

[107] *Official Committee of Unsecured Creditors of TOUSA, Inc. v. Citicorp N. Am. Inc.*, Adv. Proc. No. 08-1435 (JKO) (Bankr. S.D.Fl. October 30, 2009). It did not help Alix Partners that its fee arrangement was viewed as a contingent fee – i.e., they were to be paid if the financing worked.

§11.14 Conclusion

Various times in this paper the conclusion has been that in acquiring oil and gas assets from a financially distressed seller, a purchaser needs to carefully perform its due diligence and permit the seller to complete its orderly sale process. Liabilities need to be determined, claims paid (or reserved for) and risks assessed. That all sounds good and logical. However, in the real world of a distressed sale today, events do not unfold so precisely. Current distressed E&P companies frequently have layers of debt most of which was taken out when oil and gas prices were considerably higher. Asset sales do not generally fixed the balance sheet of today as these over leveraged companies require more fundamental changes involving the exchange of debt for equity in the reorganized entity. The values that can be obtained by asset sales in these over leveraged companies are not sufficient to enable the company to survive so a Chapter 11 restructuring is required. However, for some generally smaller entities, asset sales will be pursued as a way to address certain liquidity shortfalls. In these situations, the cautious buyer should carefully analyze any potential transaction in an effort to minimize the additional risks that surround any property acquisition from a distressed seller.