

Oil and Gas Scene



Summer 2016

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Bankruptcy in Oil and Gas Industry

by Ethan McMillan, Mineral Management Specialist

Inundated with energy company bankruptcy notices? What does it mean for your royalty payments? Due to the slump in crude oil and natural gas prices in 2015-2016, many oil and gas companies have opted for relief under Chapter 11 of the United States Bankruptcy Code. This article is a brief and general discussion of what a Chapter 11 bankruptcy is and its effect on royalty owners.

Chapter 11 Bankruptcy

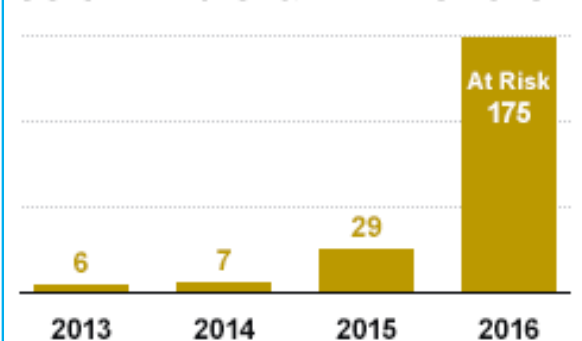
The United States Bankruptcy Code consists of a number of chapters. Filing under the different chapters offers different protections and is beyond the scope of this article. Nearly all of the bankruptcies making headlines in the oil and gas industry are of the Chapter 11 variety, so our discussion will focus on that chapter.

United States Department of Justice definition of Chapter 11 – Chapter 11 bankruptcy provides a procedure by which an individual or a business can reorganize its debt while continuing to operate. The vast majority of Chapter 11 cases are filed by businesses. The debtor, often with participation from creditors, creates a plan of reorganization under which to repay part or all of its debts.

First, the debtor (an oil and gas company for our discussion) files a petition with the bankruptcy court requesting relief under Chapter 11 that includes a summary of all assets owned by the debtor. The court will then grant an “order for relief” creating the bankruptcy estate and appointing a trustee. The estate includes all assets claimed by the debtor in its petition. The court then has exclusive jurisdiction over all of the debtor’s assets. Chapter 11 proceedings allow the debtor to continue operations in the ordinary course of business while working to reach an agreement with creditors through the bankruptcy court. The goal is to have the court approve a plan of reorganization that will specify how debts will be repaid.

Continued on Reverse Side...

U.S. OIL AND GAS E&P* BANKRUPTCIES



* Exploration and Production

Chart from Fortune Magazine, *Oil and Gas Exploration Bankruptcies Could Sextuple This Year* by Anne VanderMey, March 25, 2016



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Bankruptcy (continued from front page)

Effect of Bankruptcy on Royalty Owner

Producing Leases: Typically, royalty owners are required to be paid under the plan of reorganization or the underlying oil and gas lease will be lost. The revenue stream from leases producing pre-bankruptcy is likely to continue post-bankruptcy as the trustee, debtor, and creditors all want continued revenue flow. The trustee has discretionary latitude in distributing royalty payments to unsecured creditors (more on this below). Most often, the trustee will allow royalty payments to be allocated and paid post-bankruptcy filing just as pre-bankruptcy filing in order to keep revenue incoming to pay creditors.

Non-producing Leases: The filing of bankruptcy does not excuse the debtor/lessee from performing drilling or reworking obligations as required in the primary term of most oil and gas leases. Whether a cash-strapped entity in bankruptcy will begin drilling or reworking operations to maintain a lease will largely depend on the estimated value of the lease and the cost of the proposed/reworked well. Leasehold interests that do not expire during the period of reorganization will be unaffected.

Proactive Approach

Not all of the oil and gas companies that have filed for Chapter 11 protection will be able to service their debt and those entities will be forced into Chapter 7 bankruptcy (liquidation proceedings). Royalty owners are generally deemed unsecured creditors whose recourse varies by state. Secured creditors are paid in order of priority, as determined by the trustee, and unsecured creditors are paid out of any remaining funds. Unsecured royalty owners may well be left empty-handed for their owed unpaid royalties.

When negotiating an oil and gas lease, the Oil and Gas Division of Farmers National Company requires contractual lease language to protect the royalty interests of our clients in the event the lessee seeks bankruptcy protection. This renders our clients as secured creditors thereby elevating our client's priority for repayment in the event a debtor is unable to service its debt. Additionally, Farmers National Company monitors current bankruptcy filings and files Proof of Claim forms with the bankruptcy trustee when appropriate. Proof of Claim forms put the bankruptcy trustee on notice that clients of Farmers National Company may be secured creditors and entitled to priority treatment when paying creditors.

Royalty owners must proactively manage their interests by monitoring bankruptcy notifications and the filing of forms when necessary. The cyclical ebb and flow of crude oil and natural gas prices virtually guarantees the number of bankruptcy filings will slowly diminish. As a matter of course, the market will again plunge and bankruptcy filings will result. *Will your interests be protected during the next downturn?* Please contact us at 1-888-880-8865 for additional information!



Drilling Activity

The United States drilling rig count two years ago was over 1,900 and last year the count stood at 862. Today the national onshore rig count now sits at 374, which is now down 80% in two years. Here is the breakdown by state according to Baker Hughes for the week ending 5/27/16 for the onshore rotary rig count.

State	Last Year	Current
Alabama	5	0
Arkansas	5	0
California	11	5
Colorado	38	16
Illinois	3	1
Indiana	0	1
Kansas	13	2
Kentucky	0	3
Louisiana	37	20
New Mexico	43	18
New York	0	0
North Dakota	77	22
Oklahoma	105	59
Pennsylvania	47	16
Texas	363	173
Utah	8	3
West Virginia	19	10
Wyoming	21	7
Others	67	30
Total	862	374

Breakout Information:

Oil wells drilling:	286
Gas wells drilling:	87
Miscellaneous:	1
Horizontal drilling	299
Vertical drilling	31
Directional drilling	44

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