Chapter 11 Becomes a Way of Life for Oil and Gas Companies

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RAAM Global Energy Co. is just the latest oil and gas company to file for bankruptcy protection, but it certainly won't be the last.

The Lexington, Ky., debtor submitted its Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Texas in Houston on Oct. 26, at the end of a 12-month span that's been abysmal for the sector.

For a sense of just dismal things are looking for the space, consider the fact that two industry experts The Deal spoke to Thursday both said the exact same thing: "Things will get worse before they get better."

Nearly two dozen large oil and gas companies have ended up in bankruptcy in the past year. Exploration company Endeavour International Corp.(ENDRQ) kicked off the string of petitions, on Oct. 12, 2014. The debtor had plans to implement a restructuring support agreement that soon fell apart due to falling oil and gas prices.

Other relatively large companies followed suit soon after, including Quicksilver Resources Inc. (KWKAQ) (March 17), Sabine Oil & Gas Corp. (SOGCQ) (July 15) and Hercules Offshore Inc. (HEROQ) (Aug. 13). Smaller companies like Cal Dive International Inc.(CDVIQ) (March 3), Dune Energy Inc.(DUNRQ) (March 8), BPZ Resources Inc.(BPZRQ) (March 9),ERG Intermediate Holdings LLC (April 30)American Eagle Energy Corp. (AMZGQ) (May 8), Saratoga Resources Inc.(SARAQ) (June 16), Milagro Oil & Gas Inc.(July 15) and Miller Energy Resources Inc.(MILLQ) (Oct. 1) also ended up in bankruptcy court.

Canadian companies have also not been immune to distress in the sector. Verity Energy Ltd. on April 29 sought protection under Canada's Companies' Creditors Arrangement Act. Well-fracturing service provider Gasfrac Energy Services Inc. (Jan. 15), oil sands exploration company Southern Pacific Resource Corp. (Jan. 21), crude oil producer Laricina Energy Ltd. (March 30) and exploration company Shoreline Energy Corp. (April 9) have also done the same.

Naturally, there have been ripple effects. Companies that provide services to oil and gas companies have suffered, too. A&B Valve and Piping Systems LLC, which provides oil fields with piping, submitted its own Chapter 11 petition on Oct. 16. Broussard, La.-based A&B followed oil and gas exploration and production waste management company CCNG Energy Partners LP (Oct. 12) and piping supplier Boomerang Tube LLC(June 9) into Chapter 11.

As The Deal reported on Sept. 25, numerous oil patch companies have also hired restructuring advisers that may indicate a future Chapter 11 filing, including Vantage Drilling Co. (VTG), U.S. Shale Solutions Inc., Paragon Offshore plc(PGN), Midstates Petroleum Co. (MPO),Swift Energy Co.(SFY), Venoco Inc. and Energy XXI Ltd. (EXXI). RAAM, which The Deal said had hired advisers in August 2014, filed its own Chapter 11 petition this week.

Additionally, on Oct. 12, The Deal learned that Magnum Hunter Resources Corp.(MHR) has hired financial advisers from PJT Partners LP and legal counsel from Kirkland & Ellis LLP to help the oil and gas producer address its heavily leveraged capital structure.

William Snyder, who leads the corporate restructuring group of Deloitte Transactions and Business Analytics LLP, said many of these companies are entering bankruptcy with either prenegotiated or prepackaged plans, in part due to their very complicated debt structures.

"In such a convoluted mess, you almost have to file," he said.

Once they do file, companies that are forced to liquidate are selling at scrap value. Witness Dune Energy, whose reserves were valued at more than $1 billion. After a June 30 auction, Dune sold its 11 oil fields for only $19 million.

Meanwhile, Snyder said that lenders are running out of options. "Their hands are tied," he noted.

Lenders can provide covenant relief, but they are in no position to give overadvances, and with reserve-based lending declining, companies are "running out of runway," Snyder asserted. "They're running out of money."

He said lenders don't want to just jump ship and allow the companies to liquidate.

Kim J. Brady, senior managing director at SOLIC Capital Advisors LLC, agrees.

"Lenders aren't just willing to walk away," Brady said.

Many lenders are likely going to convert a portion of their debt into equity and free up some money to cover working capital----through a debtor-in-possession loan if the company is bankrupt, perhaps----until the market rebounds. (For example, bankrupt offshore contract drilling provider Hercules Offshore went this route. Under its plan, confirmed on Sept. 24, senior unsecured noteholders owed more than $1.2 billion, received 96.9% of the reorganized company's common equity. The noteholders also agreed to backstop a $450 million first-lien exit loan that will fund construction costs on a rig and provide Hercules with more liquidity.)

"I think in all the [upcoming] prenegotiated Chapter 11s, you're going to see that," Brady said. "Lenders know that that unless they agree to some level of restructuring----whether that involves a debt-for-equity conversion or something else----they're not going to be able to recover anything until oil prices rebound."

Snyder had a similar take. He said that there are two types of lenders for exploration and production companies----traditional reserve-based lenders, used for working capital, and alternative lenders, or holders of second-lien, third-lien and unsecured bonds.

"The money center banks are holding firm on their RBLs," he said, referring to the reserve-based loans. "They're not the fulcrum lender. It's the alternative lenders that are the fulcrum."

He later added, "What you'll see is a lot more swaps at the second-lien level."

Brady said he expects to see five to seven more of these types of companies file in the fourth quarter and the beginning of next year's first quarter. Companies he highlighted as likely to file soon include Goodrich Petroleum Corp., Swift Energy and Sandridge Energy Inc.

What type of form those cases will take remains to be seen.

In the meantime, Brady noted that it's not all bad that filings are on the rise----at least not for the companies themselves.

"You have to remember, it's actually healthy that prepackaged bankruptcies are occurring because what that means is that the companies are able to move forward and operate and [it] doesn't become a zombie company,"

Brady said. "They're restructuring so they have the right capital structure to move forward in this environment. It may not be good for the equity [holders], but for the company itself it's healthy that they can move forward and stay in business. That's a great thing in my view."

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