

E&P Restructurings: Focus on Uptiering Transactions

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Times are tough, very tough, for many mid-cap and small-cap exploration and production (“**E&P**”) companies. Crude oil prices have fallen from more than \$100/barrel in July 2014 to a twelve-year low of less than \$30/barrel in January 2016. Natural gas prices are at a three-year low. The growing consensus is that depressed prices will experience a slow recovery that may continue into the 2020s. In response, a number of overleveraged E&P companies have completed significant out-of-court restructurings since 2015, while others have filed for bankruptcy protection. Even those companies that have deleveraged their balance sheet and reduced their overall interest expense may face a liquidity crisis if commodity prices remain depressed through 2016 and beyond.

The significant, prolonged decline in commodity prices hurts E&P companies in two significant ways—first, by forcing a reduction in development activities that are unprofitable in low price environments, and second, by limiting access to capital through traditional reserve-based lending (“**RBL**”) financing. Overleveraged companies, especially those with significant senior unsecured debt, feel these effects more acutely. One telling sign is the disclosure by certain E&P companies in periodic filings with the Securities and Exchange Commission (the “**SEC**”) that they would not be able to pay contractual obligations as they became due in 2015 unless the company could complete a restructuring transaction.

The key question that these companies face is—what are the best strategic options to survive the depressed price market? While a restructuring often involves many elements, the most notable development in 2015 in out-of-court restructurings has been the use of junior lien financings and “uptiering” transactions in which companies offered a new security, often a second- or third-lien debt security or term loan, in exchange for cash or for existing senior unsecured debt.

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