

Sambur in The Deal: Factors Driving Energy Company Asset Sales

September 29, 2017

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Over the past 18 to 24 months, more than a handful of sizable U.S. oil and natural gas exploration and production companies have made their way through bankruptcy, swapped huge chunks of equity to eliminate massive debt loads and emerged from Chapter 11 protection with a tidy balance sheet, only to hire an investment bank, launch a formal review and sell assets months later, *The Deal* [reported](#).

With an uncertain commodity price environment over the coming years and the need to satisfy creditors that may ultimately press for a sale, the question becomes: Why have more U.S. oil and gas companies not opted to sell assets through Section 363 sales in Chapter 11 rather than launching reviews after emerging? ...

Samson Resources II LLC said March 29 it had tapped Jefferies LLC as lead adviser and Houlihan Lokey Inc. as co-adviser for a strategic review, which subsequently led to a number of asset sales. Also in March, Energy XXI Gulf Coast Inc. (EXXI) said it had hired Morgan Stanley to advise management on business options and strategic planning.

In late February, Jefferies launched a review for Linn Energy Inc., the reorganized successor to Linn Energy LLC that has been working to sell various noncore assets to focus on its core Oklahoma holdings. The company subsequently announced its Oklahoma assets would be committed to Roan Resources LLC, a new joint venture with Citizen Energy II LLC, while Jefferies continued to assist various other advisers in selling off the remainder of its U.S. asset base. ...

According to Haynes Boone restructuring Partner Keith Sambur, this trend likely has sprouted from creditors hoping for a rebound in the commodity market and may be somewhat unique to the upstream oil and gas industry, where a company's operations can be dormant for months at a time without necessarily losing any value.

"Oftentimes, you see 363 sales when the value of the company is best realized by selling it as a going concern, or a fully operational business," Sambur said. "When businesses are operating at losses and bankruptcy may not provide an opportunity to address those losses, creditors often balk at financing the company going-forward, but are willing to provide incremental capital to allow for a going-concern sale of the company. In that instance, a 363 sale is the best way to maximize value and for the creditors to exit that position."

"Creditors will say, 'Hey, I know I'm going to take a loss, but the best way to exit is sell assets as a going concern.'"

For upstream oil and gas companies, however, creditors don't necessarily have to pump a lot of cash into the business during or after restructuring to keep it going, Sambur added.

Instead, these companies can stop drilling and completing wells and effectively mothball operations, without the resources in the ground below becoming any less valuable. By comparison, it would be foolish for a retail store outlet to simply shut its doors and not sell its inventory throughout a bankruptcy process.

To be sure, for a distressed exploration and production company there may be certain benefits to a 363 sale, Sambur said. For one, buyers are sometimes willing to pay more for an asset in a 363 sale than directly from a distressed seller before Chapter 11, as bankruptcy protection eliminates the risk of the buyer being caught up in a fraudulent transfer lawsuit if the seller is alleged to have been insolvent and to have parted ways with the asset for less than reasonably equivalent value.

Furthermore, through 363 sales, third parties can buy assets free and clear of any claims and liabilities. For these reasons and more, buyers may actually insist a distressed company go through Chapter 11 proceedings before buying an asset, and given that bankruptcy is such an expensive process, it's reasonable to assume sellers would then demand a higher price tag. ...

"The thing about an asset sale is it forces the company and its creditors to effectively crystallize losses," Sambur explained. "Early on, the thought was oil in the \$30s and \$40s [per barrel] was a temporary glitch. [The Organization of the Petroleum Exporting Countries] was going to tighten the screws and cut production, and we were going to see rebounds."

Of course, as management teams and bondholders alike now know, that wasn't the case. But at a time when dozens of U.S. oil and gas companies were entering Chapter 11, such thinking is likely what drove companies to try to get in and out of bankruptcy quickly, then consider a sale afterward. It also is what may have propelled their creditors to accept such a proposal.

"If you're a creditor in what was perceived to be a temporarily low commodity environment, the last thing you may have wanted to do is sell assets," Sambur said. "Because if you loaned a company money at \$100 per barrel and oil is selling between \$30 and \$40 per barrel [when the debtor enters bankruptcy], you effectively crystallize your losses at let's say 65 cents on the dollar." ...

According to Sambur, investors may now be getting used to the so-called new normal in terms of pricing and subsequently considering how to best position themselves.

"If you're a distressed-control investor, you may have effectively loaned money at \$30 per barrel based upon when you bought these bonds," Sambur said. "When you look at forward strips, it doesn't look like commodity prices will hit 2014 highs anytime soon, and the underlying assets are not producing a whole lot of income for you, so you have to think, How do you start to maximize your return? How do you exit from that \$30 per barrel position so you can achieve targeted investment returns?" ...

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