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The Biggest Oil And Gas Bankruptcy Trends Of 2020

By **Keith Goldberg**

Law360 (December 23, 2020, 6:03 PM EST) -- The oil and gas industry is engulfed in its second bankruptcy wave within the last five years as 2020 comes to a close, spurred by a pandemic-induced crash in global energy demand.

According to figures compiled by Haynes and Boone LLP, 45 oil and gas drillers filed for bankruptcy in the first 11 months of the year, buried under nearly $54 billion worth of secured and unsecured debt. The picture was even grimmer for the oil field services industry, as 57 companies went bankrupt through the end of November, carrying over $41 billion in secured and unsecured debt.

Several companies that went through the previous bankruptcy wave of 2016-17 found themselves back in Chapter 11 this year. Meanwhile, midstream contract rejection fights that emerged during the previous wave became a fixture this time around.

Many companies were still able to convince some of their major creditors to swap their debt for equity in a reorganized company. But for those that couldn't, the alternative of selling off assets faced major headwinds amid persistently low oil prices and the COVID-19 pandemic's continued drag on energy demand.

Here are four oil and gas bankruptcy trends that stood out to attorneys in 2020.

Return of the Prepacks

While oil and gas bankruptcies have been numerous this year, they haven't been legal free-for-alls, for the most part.

The bankruptcy of natural gas giant Chesapeake Energy Corp. is a high-profile exception, but attorneys say the majority of Chapter 11 filings have been prepackaged plans that let lenders swap debt for equity and inject additional cash into the reorganized company.

Even filings that weren't complete prepackages included a sizable restructuring support agreement with major debt holders.

"It's almost unheard of now to have a case filed without some kind of prearranged restructuring process in place," McKool Smith PC bankruptcy principal John Sparacino said.

There was fear earlier this year that prepackaged bankruptcies would be harder to broker compared with the 2016-17 wave. But Hunton Andrews Kurth LLP bankruptcy partner David Zdunkewicz said the double-whammy of the pandemic and global oil price war that exacerbated a supply glut and sent prices tumbling to historic lows may have actually made prepacks easier to pull off. Companies and their lenders simply didn't have many viable options, he said.

"That was such a big, major shock that boards of directors had to go to their lenders real quick and say, 'Look, at this low [oil price], we just can't service this debt and so we have to restructure,'" Zdunkewicz said. "That happened so quickly, that there was pretty much nothing to fight over."

Midstream Contract Rejection Battles Heat Up

As driller bankruptcies piled up this year, so did efforts by drillers to renegotiate or ditch gathering and transportation contracts with pipelines and other midstream companies, attorneys say. It's a natural outgrowth of a 2016 bankruptcy court decision that Sabine Oil and Gas Corp. could reject gas-gathering contracts in bankruptcy because they didn't contain covenants that tied the contracts to Sabine's drilling properties — a concept known as "running with the land" — as interpreted by Texas law.

"It's becoming a much more common feature of an [exploration and production company] Chapter 11 these days," Sparacino said.

That's been fueled by more bankruptcy courts weighing in on whether midstream contracts run with the land under laws in different states. For example, a bankruptcy judge in October said that under Colorado law, bankrupt driller Extraction Oil & Gas Inc. could reject a transportation agreement with a Colorado-based pipeline company because the agreement didn't contain covenants that run with the land.

"For some upstream companies, that might motivate them to file bankruptcy if they were kind of on the fence about it," said Kraig Grahmann, who heads Haynes and Boone's energy finance practice group. "For midstream companies that were relying on these minimum volume commitments to keep themselves afloat ... then [in] 2021, especially for the field-level gatherers or processors, that's something that will create a lot of distress in that space."

Rise of the Chapter 22s

Attorneys say one indication of the financial reckoning that's hitting the oil and gas industry is the number of so-called Chapter 22s, or repeat bankruptcies.

Five drillers and oil field service companies made a return trip to Chapter 11 in the first 11 months of the year, according to figures compiled by Haynes and Boone. Four of those five companies made their initial Chapter 11 journey during the 2016-17 bankruptcy wave.

When lenders decide to leave some debt on a reorganized company's books, they're making a calculated gamble that they'll be able to service that debt as oil prices recover, attorneys say.

"In bankruptcy number one, you greatly lower the senior secured debt, but the fulcrum security holders say, 'We don't want to convert everything to equity, we want to keep some of our debt on,'" Sparacino said. "To me, that's them making an informed decision that has some risk associated with it."

The current oil slump highlights the downside of that strategy for companies, attorneys say.

"They really thought they could service that debt with future prices, but a problem comes along and all of a sudden, the price goes down," Zdunkewicz said. "That's when you have to restructure again because the prices just didn't go your way."

Sluggish Market for Asset Sales

Not only has the prolonged oil slump driven dozens of companies into bankruptcy, it's also made it harder for lenders to salvage what they can from a bankrupt firm through Section 363 asset sales, attorneys say.

"The sales are not that attractive right now, by and large," Zdunkewicz said. "It's almost like a last resort."

Sparacino said that's prompted some lenders to get into the auction process and buy the assets themselves in the hope of flipping them down the road if oil prices improve.

But not all lenders are showing that kind of patience. Grahmann said banks and other holders of reserve-based loans — a staple of oil and gas lending that's based on a producer's total reserves and the price of oil — have been willing to take major haircuts by forcing asset sales at bargain-basement prices.

Grahmann pointed to Southeast regional bank Hancock Whitney Corp.'s July agreement to sell its entire reserve-based loan portfolio to funds managed by distressed debt specialist Oaktree Capital Management LP. Hancock Whitney sold at a deep discount, receiving just over $257 million for $497 million worth of reserve-based loans, and midstream and nondrilling service credits.

"For a reserve-based lender to say, 'I'm willing to sell to someone like that,' that means that they've sold at very low prices and were willing to just throw in the towel on the portfolio, even though ... people say it's the bottom of the market right now," Grahmann said.

--Additional reporting by Vince Sullivan. Editing by Aaron Pelc and Marygrace Murphy.

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