



Texas Land & Mineral Owners Association

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WHEN YOUR OIL COMPANY OR OIL & GAS PURCHASER GOES BROKE

A Royalty and Mineral Owner's Perspective and Action Plan for When You Receive Notice from the United States Bankruptcy Court

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Greetings! You receive a very official Adjudged and Decreed from a U.S. Bankruptcy Judge in your mailbox this month....instead of a check! Your reactions are as follows: 1) shock and denial, 2) bewilderment, 3) anger, and 4) what do I do now to protect my assets (mineral rights), cash flow (royalty lease rights and cash flow) and get monies I will likely be due?

WARNING: A tidal wave of oil and gas operation bankruptcies are coming to Texas. Stay calm, stay organized, and don't try this at home without a lawyer.

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The fundamental framework of bankruptcy in U.S. law is historic and may be grounded in Old Testament time based on the concept of debt forgiveness, or starting over. The Year of Jubilee basically allowed all debts to be forgiven approximately every fifty years for a cleansing, fresh start, or flushing the toilet of debt. It is interesting that bankruptcy and depression cycles seem to happen in waves about every fifty years in the U.S. economy (when not influenced by artificial low interest rates and "quantitative economic easing" by the feds!)

There are generally two types of bankruptcy filings that oil company operators/debtors or their creditors file:

1. Voluntary Chapter 11 occurs when the operator/debtor proactively files a bankruptcy because of excessive long or short term debts, bills, obligations, overhead, pending lawsuits, judgments or unpaid obligations that exceed their available cash or cash flows. The debtor/operator seeks the mercy of the court for a stay, an opportunity to stop the bleeding, to reorganize their affairs, obligations, and debts—extend them, suspend them, or have them canceled or forgiven. A "reorganization plan" is filed, presented, and argued for by lawyers and appraisers to theoretically allow the operator/debtor to survive over time (reorganize and prioritize debts and obligations). They may also file a negotiated settlement or partial payment, over time, of obligations to service companies, frac companies, workover rigs, etc. Sometimes the federal judge forces the creditors to accept a reorganization or discount of monies due. The debtor and court make pleas to change debt terms or amounts due, commonly known as "cram down." The judge and trustee determine the best course of action to assure as many creditors the best potential plan to collect and also to give the oil company a chance to recover (i.e. if operations improve, or oil and gas market prices improve over time).
2. Involuntary or Voluntary Chapter 7 requires the operator/debtor to liquidate or sell all assets (working interests, leases, equipment, etc.) to the highest bidder in order to pay whatever is left after legal fees and trustee fees have been paid to the creditors. Quite often, a Chapter 11 filing is converted or forced by the creditors and judge to a Chapter 7 if it is determined by the court there is little-to-no hope the operator/debtor will survive reorganization even if given a second chance. Through Chapter 7, the total assets of the operator/debtor (or present value of the cash flow) are generally less than or equal to the debts or obligations.

Simplified points of view and recommendations for when you receive a bankruptcy notice:

1. Read the bankruptcy notice carefully:

- a. Do NOT contact the staff of the bankruptcy court or clerk's office – they can't help you.
- b. The attorney for the debtor is NOT your friend. Although all contact information and telephone numbers are listed, calling the debtor's attorney is a waste of time.
- c. Pay attention to deadlines for filing requirements, proofs of claims, proofs of property ownership, royalties and monies owed.
- d. The meeting of creditors (date, time, and location will be listed) is generally NOT important for royalty owners to attend, but is attended by lawyers representing banks, bond holders, and service companies owed money. Mineral and royalty owners may feel like a speck in a sea of legal eagles and can do nothing to help their cause at this meeting.
- e. Deadlines to file proof of claims are important. Collect bona fide proofs you own and are owed funds and will be owed growing amounts of royalty money during the sometimes very long periods of the bankruptcy legal daisy chain! Sometimes royalty payments stop when a stay is granted, but the wells continue to produce. In these instances, the court-appointed trustee simply collects and stores money and accounts for payment of monthly funds. Other times, a court-appointed receiver or operator takes over all operations, and payments of royalties continue. Sometimes you hear nothing and receive nothing for months, but have faith in the courts and be patient. (This assumes you have filed your claims, proof of ownership, etc., on time and properly).
- f. Caution! You may not interfere with the collateral, lease, operations of the debtor, or take matters into your own hands (i.e.: shut "your" well in to prevent stealing of "your" oil and royalty). There are federal warnings against such actions.

2. Collect a complete and consolidated file of information and proofs of ownership in one document—have a hard copy for the attorney and scanned computer-file version for filing with court clerk. More information is better than less! The file should include the following:

- a. Copy of your original oil and gas lease with complete legal descriptions, even if farmed out to another company;
- b. Copy of all division orders on all leases operated by the debtor;
- c. Copies of the most recent checks showing payment to you or your ownership entity—including both the top and bottom of check is best if available as this also shows volumes of oil and gas, depletion, and trend lines;
- d. Summary of historic production and income per well or lease for not less than one year—find this on form check stubs or Texas Railroad Commission data; and
- e. Hard part! Estimate the royalty and overriding royalty income you have not been paid if there are payment gaps, skips, or you have not gotten paid lately. Note the gross royalty, not net royalty after severance taxes and historic expenses or deductions for compression, pipeline charges, etc.

3. Contact a qualified attorney to file your royalty claims and paper work. It is best to hire the attorney by the job (fixed amount) and not hourly. THE MORE ORGANIZED YOU ARE, THE LESS IT WILL COST! Collect all information and a copy of the bankruptcy notice in one consolidated file that may be scanned and submitted to the clerk of the court by your attorney.

4. You are part of a class of creditors: Royalty owners generally rank and get a higher ranking and get paid. Sometimes, however, things like overriding royalty income, surface damages, and water sales are put in lower-priority classes for payment. Consult your attorney on these special matters.

Conclusion: Bankruptcy notices on our royalty income streams from our land and minerals are a shock and no fun. Relax, but only after you have filed your claim using an attorney to assure proper filing, accounting, and deadlines. I've been through three of these nightmares and am pleased to report I always came out better after it was over! I got a better operator, often more new wells drilled, and have always eventually gotten paid funds that were documented or estimated properly, although my "brilliant" lease provisions, terms, and obligations—continuous drilling clauses, royalty payment penalties (if late), maintenance of roads, etc.—often got delayed.

Best Advice: 1. Periscopes up! There are 60 oil and gas firms on the Standard and Poor's watch-list for bankruptcies. Check the list and look for your operator's name. Also, watch out for the delisting of a public company by a stock exchange (for example, Quicksilver Resources was delisted, its stock dropped to 8 cents on February 15, 2015 due to bond and debt levels). Bankrupt-possible companies may bounce royalty checks, or you may see a sudden slow-to-no-payment of royalties. These things are all red flags, and you should be prepared. Stay vigilant, but not paranoid.

2. Stay calm, stay organized, and don't try this at home without a lawyer.

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