

Surviving an Energy Industry Down-Cycle

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Resulting financial stress on your business can be survived

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As we all know all too well, the profitability of the energy industry is dependent on oil and gas prices, which are often volatile and generally cyclical. Unfortunately, we in the oil and gas business are in the midst of another industry down-cycle.

According to the recent Baker Hughes' North America Rig Count report, the number of rigs drilling for oil and natural gas has been cut in half since November. The price of oil has been cut by more than half as compared to last year. In response to lower prices, some oil and gas companies have reportedly reduced their capital expenditure budgets, reported substantial losses, and are selling off assets. Service and drilling companies have announced major layoffs and so far appear to have been the hardest hit.

Under these circumstances, virtually all companies that are engaged in the Oklahoma energy sector, whether they are exploration and production or service companies, are dealing with reduced profitability and some are struggling to meet their financial obligations.

When a company that relies on a robust energy sector starts to feel the pinch of a down-cycle, restructuring debt or seeking relief through a Chapter 11 bankruptcy reorganization may be the way for the business to survive. Either the workout or a bankruptcy allows the business to have some time for the economy or business sector to recover or for the business to work through its financial difficulties.

What to do?

When a company is experiencing financial stress, the best course of action is to accept the reality of the situation and address it quickly. The first step is for the business to

develop a budget so that it has a clear understanding of its current monthly revenues and expenses, its projected future revenues and expenses based upon reasonable assumptions, and the current and estimated future value of its assets. Once the business has that information, it can develop a pragmatic approach to dealing with its expenses and liabilities and will then be ready to approach its creditors with a plan for restructuring.

“If a company is having trouble meeting its obligations, creditors want to know why, what is being done to address the situation and, ultimately, what the overall prospects for recovery are for the business, both outside and through bankruptcy.” said Phillips Murrah bankruptcy attorney Stephen W. Elliott.

The Workout: Avoiding Bankruptcy

A workout is an out-of-court process through which the business owner and the creditors of the business try to reach an agreement to modify the terms of their contractual obligations. Workouts typically involve an agreement of the business' primary lender to waive defaults or forbear on the lender's rights to collect interest and principal payments on the loan for a period of time to give the business the opportunity to get back on its feet. The workout terms may include debt forgiveness, changes in loan amortization, reduced interest rates, or deferred principal or interest payments.

The ultimate goal of the workout is to allow the business to continue operating so that (i) the creditors of the business can ultimately be paid more than they would have received if the business was shut down and the assets were sold at liquidation prices; and (ii) the business can recover from its financial difficulties, all without the costs, delays, and potential uncertainties frequently inherent in bankruptcy. If the workout would be as or more beneficial to the business and

its primary creditors than a bankruptcy, then bankruptcy can often be avoided.

“In my experience, candid communication is often the key to avoiding bankruptcy and resolving financial issues through a workout,” Elliott continued.

What are Benefits of Bankruptcy?

Bankruptcy provides potential, wide-ranging benefits to the debtor not available through out-of-court workouts. In a Chapter 11, the debtor oftentimes acts as trustee of the business and continues to manage the company as the “debtor in possession.” Chapter 11 affords the business a number of tools to restructure its debt.

One of the best known is the automatic stay which stops collection efforts outside of the bankruptcy court and keeps the business and its assets from being picked apart piecemeal by creditors. Additionally, in bankruptcy, the business may be able to obtain financing on more favorable terms than it could outside of bankruptcy by giving the post-bankruptcy lender priority over other creditors. Also, there is the possibility in bankruptcy for the business to be able to rapidly sell assets free and clear of liens and even over creditors’ objections, which under some circumstances may be the only way for the business to be able to sell its assets for fair market (as opposed to liquidation) value or to obtain funds to continue the operations.

Finally, the bankruptcy process provides the business with the opportunity for the bankruptcy court to bind creditors involuntarily to the reorganization plan of the business. The reorganization plan may restructure obligations and discharge debts of the business. This ability of the bankruptcy court to bind creditors can be critical if the business owner’s efforts to put a workout together have failed due to some creditors’ refusal to agree to the proposed workout terms or because

there are too many creditors for the business to be able reach an agreement with them.

Action Beats Hesitation

The best course of action for the business owner to deal with financial stress on the business is to be proactive, regardless of whether the solution is in the form of a workout or entails a bankruptcy. Communication among the business and its creditors is very important. Generally the earlier the lines of communication are opened between the business and its creditors, the better the chances are of a successful resolution. The failure of the business to communicate with its creditors concerning its financial stress will often result in creditors assuming the worst and taking legal action that the creditor might not have taken if the business owner had simply communicated with them. Once those collection actions have begun, filing bankruptcy may be the only course of action available to save the business.

A business owner's denial of the precarious financial situation of the business or inaction can result in a needless loss of business value and can potentially impair the business' ability to restructure or reorganize and survive the financial crisis. If you find that your business is in a precarious financial situation, taking action now may minimize the problems created by the down-turn.

About the author:

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