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The Oil Bust…Bankruptcy Boom?

Authors: Edward Arnold, Jan Marie Hayden
February 06, 2016

Although the news is filled with stories of falling oil and gas prices and suggestions that a third of the exploration and production companies may file for bankruptcy, this most recent downturn may not produce the bankruptcy filing boom many anticipate. True, some overleveraged E&Ps will likely file, if for no other reason than to provide an orderly transfer of their reserves and their attendant plugging and abandonment liabilities. These cases will likely involve quick Section 363 sales, or now more likely, debt for equity transactions, but service providers such as vessel operators, rig operators and other suppliers will likely not find filing petitions for relief particularly useful – nor might their lenders.

Chapter 11 is designed to help a company solve its problem, not a global commodity problem. Here the forces driving the downturn are totally out of the control of the service providers – worldwide oversupply, diminished control by the OPEC, the strength of the U.S. dollar, geopolitical issues – what is the supplier here in the United States to do? With predictions of this slump lasting through 2017 and perhaps beyond, Chapter 11 will not provide the relief to forestall action throughout the downturn. That means that service providers need to address issues now and find solutions that don't require filings. Larger providers with sufficient capital available to ride out the storm are likely to find themselves nevertheless making draconian cuts to survive. Consolidation of operations through mergers may prove to be a good strategy. Seeking restructuring advice now makes sense because proactively addressing the downturn with a business plan will not only increase chances of survival, but may give lenders and trade creditors confidence in management's ability to address the issue. Midsize and small providers may simply find themselves in a no win situation. All should consider adjusting business models to respond to the slump – is there a way to hold onto skilled and necessary labor? There will be lenders with stacked collateral – can your company offer services to those lenders? Is there equipment that can be cold stacked or moth balled? Maybe some destined for obsolescence that should be scrapped now?

Lenders will need to carefully consider what collateral recovery will entail. For instance, it is likely that many service vessels will be tied up, but unlike real estate or other collateral you simply don't tie up the vessel and wait for someone to buy it years from now. The holding costs are significant; not only the cost of docking, but crews must be maintained, engines run and the vessels themselves need to be maintained against the elements. Returning to service will likely require dry docking. All of this will be added to traditional holding costs, such as port risk insurance and protection services. Recognize that the lender also faces the potential for growing obsolescence the longer a piece of equipment sits, so collateral recovery may simply mean recovering scrap value. A careful evaluation of these costs should be done in evaluating the lender's position vis-a-vis a debtor. Consistent with the adage that crisis accelerates change, we can expect to see continued consolidation in the L&P and service sectors. If you have a good operator in place who can be trusted to maintain the equipment or assets, keeping that operator alive may prove more valuable than any collateral recovery you could obtain in this market. Using that operator to maintain and care for other collateral you recover could help keep the competent but struggling operator afloat and preserve collateral value.