“Generally speaking, directors and officers continue to be protected by the business judgment rule—meaning that they will not be held liable for their decisions, so long as they act rationally and in the interests of the corporation.”

Rick Kuebel has extensive experience in oil, gas, and energy related bankruptcies and corporate restructuring solutions. Rick has represented numerous energy companies in business litigation or arbitration matters and regulatory disputes involving oil and gas exploration, development, transportation, refining and marketing.

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Drop in Commodity Pricing, Liquidity Drives ‘Upstream’ Bankruptcy Filings

Editor’s Note: This is one in a continuing series of Q&As with Locke Lord lawyers on key legal issues confronting companies engaged in industries that have national and global impact.

What are the characteristics of the energy companies that are seeking bankruptcy protection at this point in the current cycle?

A: With respect to “upstream” sector companies that have sought bankruptcy protection over the past few months, most if not all have been driven to file by a dramatic decline in commodity pricing and resulting liquidity constraints. Including both reductions in top line revenue and reserve restatement.

Are you seeing any successful standalone reorganizations of energy companies? What restructuring approaches are you seeing distressed energy companies take in this cycle? What issues are provoking litigation in the bankruptcy cases of these energy companies?

A: At this early point in the current cycle, most of the energy sector bankruptcy cases that we follow are resulting in either liquidation or debt to equity conversions. In “liquidation” cases, we have observed litigation over security rights, cash collateral use, the sale and bidding process and distribution of sale proceeds.

Should directors and officers of financially distressed energy companies be concerned about potential exposure resulting from their service?

A: Generally speaking, directors and officers continue to be protected by the business judgment rule—meaning that they will not be held liable for their decisions, so long as they act rationally and in the interests of the corporation. However, where the directors and officers are self-interested or otherwise conflicted, their conduct will be judged under the more demanding “entire fairness” standard. Directors and officers for financially stressed or distressed energy companies can expect to be second guessed frequently—especially where there is continued price volatility and substantial leverage in the capital structure. Liquidate or recapitalize too soon, and the existing equity holders will be unfairly diluted. Wait too long to liquidate, and the creditors will see their recoveries eroded. Either way, disappointed stakeholders may seek to hold the directors and officers responsible for any bad outcomes that may ensue.

How can directors and officers of financially distressed energy companies protect themselves from this kind of Monday morning quarterbacking?

A: First and most importantly, directors and officers need to avoid voting or acting on issues in which they or their equity sponsors have a direct financial interest. Where appropriate, the company should retain independent directors, appoint special committees or, in some instances, both. Ultimately, good process is the strongest protection against liability for directors and officers. The board should develop a clear and well documented record of good process that they follow. The board should have a clear understanding of the strategic alternatives available to the company, and consult outside professionals as needed to fully form those alternatives.

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