Investing in Distressed Assets and Companies

The Coming Opportunities
I. WHAT IS DIFFERENT TODAY FOR DISTRESSED ASSET INVESTING AND WHY?

A. Restructuring and Distressed M&A
   1. We are likely entering a period of unprecedented restructuring and distressed M&A activity
   2. Secured debt represents a much greater proportion of value than in previous cycles

B. Second Lien Surge
   1. Second lien loans are now a substantial component of the debt market
   2. The past three years have seen a surge in 2nd lien debt, increasing overall leverage and complicating both in- and out-of-court restructurings

C. The Next Restructuring Cycle
   1. Financing frenzy and easy credit have led to historically low defaults from 2004 through 2007
   2. Huge increase in high-yield and leveraged loan volumes (including 2nd lien)
   3. The worst is likely yet to come, based upon the historical 2-4 year lag between new issuance and defaults
   4. E&P Loans – Borrowing Base Resets will cause new stress on Borrower liquidity
   5. E&P Hedges – As "in-the-money" hedges roll off, lower prices will create cash flow stress

D. The Next Wave of Restructurings
   1. Covenant-Lite – Weaker covenants will provide less warning before distress and prevent ability of lenders to take control of situations early
   2. Changes to Bankruptcy Code – reduced a debtor's exclusive time and control of the process
      (a) Increased pre-bankruptcy planning
      (b) Increased frequency of distressed M&A/asset sales/§ 363 transactions
      (c) Greater scrutiny of insiders (fiduciary issues and fraudulent conveyance, etc.)
(d) Increased rights of utilities and trade creditors ("critical vendors," reclamation, prepay, etc.)

(e) Time limits on exclusivity and real estate/lease decisions move cases to a quicker exit

3. **Second Lien Implications** – Expanded presence of large amounts of 2nd lien debt (replacing high yield and unsecured debt) will have a dramatic effect on future restructurings

   (a) Fewer unencumbered assets to secure DIP financing

   (b) Adds complexity and makes cram-down more difficult

4. **Aggressive Senior Lenders** – As a result of increased levels of secured debt, senior secured lenders are deeper into capital structures and will be more in control of restructuring transactions than in the past

   (a) Some bank debt is functional equivalent of unsecured notes that were equitized in last cycle

   (b) As values deteriorate, even less-aggressive bank lenders will have zero equity or negative equity in their secured asset position

   (c) Robust secondary market – senior secured debt no longer restricted to traditional bank lenders

      (i) Secondary purchasers/non-traditional lenders typically (i) less focused on long-term banking relationships, (ii) willing to accept greater risk, and (iii) more bankruptcy savvy.

      (ii) Deals are further complicated by an increase in equity sponsors in secured debt positions

5. **More Distressed M&A**

   (a) Strategic buyers increasingly willing to purchase distressed assets; they better understand and appreciate the benefits of the process and opportunities; but more risk adverse and slower to move

   (b) Secured creditors likely to force faster, less costly, Chapter 11 cases

      (i) More § 363 sales with credit bids

      (ii) Private equity buyers are likely to continue to have a tougher time finding good deals and will be required to write bigger equity checks
(c) Increased Use of Chapter 11 in Sale Processes
   (i) Courts more comfortable with filings to effectuate a sale
   (ii) Established ground rules – expense reimbursement, break-up fees, diligence and other closing conditions, overbid protections and auction timing and procedures
   (iii) Assets can be sold free and clear of all liens and liabilities – attractive to buyers
   (iv) Buyers may be concerned about subsequent fraudulent conveyance actions

6. Financing Issues
   (a) Credit markets are so tight that financial buyers are having difficulty getting financing
      (i) Secured creditors may have to stay involved in deals and provide financing in order to execute a transaction
      (ii) Strategic acquirors with cash are in the catbird seat
   (b) Lack of Third-Party DIP Financing
      (i) Favors fast deals
      (ii) Leverage for incumbent lenders

7. Why Acquire Distressed Assets?
   (a) Creative deal makers can obtain significant advantages in distressed situations:
      (i) Acquire valuable assets at “special situation” prices
      (ii) “First mover” buyers can sometimes be the “only game in town” and thus gain advantages and special protections in a Chapter 11 process
      (iii) Not everybody can do it – less competition for deals at all value levels given difficulty, time, and expertise required
   (b) Valuable assets and good companies with bad capital structures will likely become available in the upcoming restructuring wave
      (i) A key element of the process is making the cost/benefit judgment of where, when, and even whether to get involved
II. HOW DO YOU PLAY THE GAME?

A. Bankruptcy and Restructuring in Today’s Environment

1. Traditional Chapter 11 Restructurings gone from the middle market
   (a) Very limited DIP financing
   (b) Speed from filing to § 363 sales has been reduced to 8-12 weeks
   (c) Key is speed; cases move much faster than before

2. Strategic buyers not currently participating

3. Due Diligence Issues and Questions
   (a) Due diligence is more complex, but must be done quickly
   (b) Flawed business or excessive leverage?
   (c) Off-balance sheet contingent liabilities
   (d) Personnel investigation
      (i) Do key employees remain?
      (ii) Are employees demoralized?
      (iii) Have employees walked off with key knowledge on intellectual property?

4. What is the purpose of restructurings outside of bankruptcy?
   (a) Preserve going concern value by:
      (i) reducing or deferring debt service
      (ii) modifying or eliminating restrictive covenants
      (iii) avoidance of Bankruptcy stigma
      (iv) limiting expense

5. Is restructuring under Chapter 11 an option?
   (a) Does the company possess realistic growth opportunities and predictable cash flows to support the refinancing?
   (b) Can “orchestration” among many different stakeholders (creditors, employees, unions, suppliers, etc.) be achieved in time?
(c) Non-economic/legal factors drive the ability to execute a restructuring: egos and personalities

(d) Identification of the real parties in interest who will be impediments

(e) Creditors at multiple levels of the debtor’s capital structure

(f) Debtors have creditors that are themselves in distress

(g) Recent amendments to the Bankruptcy Code

B. Alternative Approaches to Acquisition of (or Investment in) Troubled Entities or Assets

1. Purchase or invest in entity (without extraordinary remedy, i.e., bankruptcy or foreclosure)
   (a) Pros
      (i) Motivated seller, i.e., price is right
   (b) Cons
      (i) No protection from “tail” liabilities, i.e., existing trade and other debt remains with acquired company
      (ii) Price subject to re-examination under fraudulent transfer laws (i.e., price inadequate, was sale intended to hinder or delay creditors, did sale render the seller insolvent, etc.)

2. Purchase assets (without extraordinary remedy, i.e., bankruptcy or foreclosure)
   (a) Pros and Cons – Same as above (liabilities follow assets)

3. Buy assets through foreclosure
   (a) Pros
      (i) Can cut off inferior claims, including trade claims
      (ii) If sale properly noticed and regularly conducted, price is considered adequate, i.e., no fraudulent transfer remedy
      (iii) Cheaper than Chapter 11 remedies
   (b) Cons
      (i) If IRS (with inferior tax lien) not put on notice it will have right of redemption of acquired assets
(ii) Sale will not cut off “secret” superior lien claims, i.e., ad valorem tax claims (arise on January 1 of each year and automatically attach to real and personal property)

4. Purchase **entity** through bankruptcy (customary structure is to transfer sale proceeds – after payment of secured liabilities, ad valorem tax claims and closing costs – together with any unsold assets or residual assets, such as avoidance actions, to a liquidating trust for distribution to creditors

(a) Pros

(i) Court order approving sale (i) cuts off “tail” liabilities and claims of successor liability, (ii) no fraudulent transfer claims, and (iii) if order contains “good faith” finding, closing will moot any appeal of sale order

(ii) Acquired company can shed burdensome executory contracts (i.e., contracts with material performance due by parties on both sides of contract

(b) Cons

(i) Process is expensive – professional fees, if a creditors committee is appointed, can double costs of case

(ii) Unless plan is pre-negotiated, i.e., a “pre-pack,” can be time-consuming

(iii) Costs of case often unknowable at time of filing (organization of creditors committee, utility costs, reclamation claims, employee priority claims)

(iv) Some tax benefits lost if company is sold due to change of control rules

5. Purchase **assets** through bankruptcy

(a) Pros

(i) Court order approving sale (i) cuts off “tail” liabilities as to acquired assets, (ii) no fraudulent transfer claims, and (iii) if order contains “good faith” finding, closing will moot any appeal of sale order

(ii) Claims of creditors, known and unknown, attaches to sale proceeds, not to assets

(b) Cons

(i) Courts HATE “stranded” cases, i.e., cases where assets sold and case then muddles along without plan or direction; court
may require filing of plan as predicate to sale or even condition sale on contemporaneous confirmation of plan

(ii) Offer for assets makes the market – may be used as stalking horse bid for auction of assets – protection is court-(pre)approved breakup fee

(iii) If no agreement made with secured debt, may be bidding cash against the secured creditor’s credit bid

(iv) Acquisition of secured claim to allow credit bid (with value of claim treated at par) may run into resistance from court which is not inclined to serve as the secured creditor’s “title insurer”

III. HOW CAN BURLESON COOKE HELP YOU?

A. Firm Description

- We are a 25+ attorney law firm located in downtown Houston.

- Our focus is on the energy industry, which we broadly define as companies that produce energy, or provide goods or services to the energy industry. We also do a lot of work for clients outside of the energy industry.

  - We cover the practice areas most needed by Private Equity portfolio companies, including:
    - Mergers and Acquisitions
    - Securities and Corporate Governance
    - Oil & Gas (including Title work)
    - Finance
    - Bankruptcy and Restructuring
    - Intellectual Property
    - Real Estate
    - Environmental Law
    - Litigation and Dispute Resolution
    - Tax

- Our attorneys are predominantly senior level attorneys with a great breadth and depth of experience. They come from major law firms and large corporations. Several of our attorneys are former General Counsels who have the legal and business experience appreciated by clients.

- Our attorneys have the experience and judgment to deliver the practical advice needed by small and mid-sized companies, and know how to solve problems.

- Our rates are far more affordable than the major law firms.
• We have a different business model for delivering high quality legal services, and our clients appreciate the difference.

B. Bankruptcy and Restructuring Practice

1. Burleson Cooke’s Bankruptcy and Restructuring team draws upon the knowledge and expertise of attorneys throughout the firm to provide a comprehensive range of skills, services, and resources to energy-focused capital markets participants.

2. Our attorneys have bankruptcy and restructuring experience that is unique to the energy industry. Additionally, their deep, direct understanding of business objectives enables us to pursue and achieve practical solutions to fiscal problems.

3. Our team recognizes the larger context of distressed financial conditions, and extends to other areas - including environmental liability, employment and labor, securities, banking, tax, contracts, real estate, and litigation. That enables us to provide a wider range of counsel on a wider range of issues.

4. Burleson Cooke attorneys have represented debtors, secured and unsecured creditors, equity holders, creditors committees, equity committees, purchasers, investors, landlords, and trustees in bankruptcy. We have worked in Texas, throughout the region, and across the country. While we often seek to achieve fast, satisfactory results out of court, we are equally prepared to be aggressive advocates in bankruptcy court and other federal and state district court proceedings.

5. Our capabilities include:

- Energy Lending
- Leveraged Acquisitions
- Workouts, turnarounds, and restructurings
- Senior and subordinated debt financings
- Liquidation proceedings
- Alternative dispute resolution
- Chapter 11 reorganization plans and post-reorganization matters.
- Creditor representation in Chapter 7 cases
- Bankruptcy litigation
- Distressed asset sales and acquisitions
- Foreclosures and collections
- DIP Financing
C. The Team

Corporate
Rick Burleson
Allan Conge
Paul Pryzant

Bankruptcy & Restructuring
Tom Henderson
David Livingston

Financing
Kim Cagle

Oil & Gas
Kirby Barry
Tim Stephens
Paul Yale

I. CORPORATE

Richard Burleson
Rick Burleson has over 25 years of experience with a broad business practice in the areas of mergers and acquisitions, corporate finance and energy. His clients include independent oil and gas companies, private equity groups, senior and mezzanine lenders and other public and privately held businesses in the oil and gas industry.

Mr. Burleson's experience centers around structuring acquisitions and divestitures and other M&A transactions, including negotiation and documentation of letters of intent, purchase and sale agreements, equity contribution, subordinated debt, partnership and shareholder agreements, as well as senior secured loan and security agreements.

Allan Conge
Allan Conge has 19 years of experience providing legal advice to NYSE and Fortune 500 companies. He has served as in-house SEC counsel responsible for the preparation and filing of 1934 Act documents and provides legal advice to senior management and boards of directors with respect to corporate governance matters, including the Sarbanes-Oxley Act. He has also represented public and private corporations in connection with mergers and acquisitions, corporate financings and commercial transactions.

Mr. Conge began his legal career at Vinson & Elkins in Houston, Texas and spent many years serving as in-house counsel for Houston area corporations.
**Paul Pryzant**

Paul Pryzant has over 25 years of experience as a corporate and securities attorney working with both public and private clients ranging from startups to large public companies. He joined Burleson Cooke in March 2008. Prior to joining Burleson Cooke, he had been Senior Counsel at Locke Lord Bissell & Liddell LLP.

Mr. Pryzant’s experience includes serving as general counsel of a NYSE-listed truck parts distribution company, which grew aggressively through acquisitions, and as general counsel of a leading Internet chemical exchange. During his career in private practice, he also has served as the outside general counsel to a number of public companies, most recently to Pioneer Companies, a chlor-alkali products manufacturer, in 2006 and 2007.

Mr. Pryzant’s background includes experience in a broad range of mergers, acquisitions, and complex transactions, as well as 1933 Act and 1934 Act securities filings. He has assisted companies raise capital through private placements and public offerings, including initial public offerings, and represented both start-up companies and private equity investors.

**II. OIL & GAS**

**Kirby Barry**

Mr. Barry has practiced oil and gas law for over 29 years, with a broad background in the energy field. His experience includes advising oil and gas companies in support of all phases of operational issues, preparation of agreements, regulatory matters, acquisition and divestiture of oil and gas assets, financing and litigation.

Mr. Barry began his oil and gas practice in New Orleans, Louisiana in 1977 working in the litigation section of the Jones, Walker, Waechter, Poitevent, Carriere & Denegre and Phelps, Dunbar law firms. He later joined the law department at Gulf Oil Corporation where he gained broad experience in the oil and gas area, practicing in both the offshore and onshore environments, oil and gas marketing and in the Gulf's Marketing and Refining Area. After being transferred by Gulf Oil Corporation to Houston, he became the senior attorney responsible for legal support for Gulf Oil's Houston Division which covered the geographical area of Texas, Louisiana, Arkansas, Mississippi, Alabama and was the attorney for Gulf Oil's Alaska task force. Thereafter, he joined Kaneb Services, Inc. and provided legal support for Kaneb's oil and gas operations, both domestically and internationally. In 1987 he became the General Counsel and Vice President of Land of TOTAL Minatome Corporation, a wholly owned affiliate of TOTAL, SA until it was sold in 1998. While at TOTAL, he was a member of the senior management team, in addition to being responsible for legal support of all the functions for this oil and gas exploration and production company, but was a member of its senior management team. Since leaving TOTAL Minatome Corporation at the end of 1998, he has been in the private practice of law.
**Tim Stephens**

Mr. Stephens' extensive background in the oil and gas industry includes corporate reorganizations, acquisitions, business turnarounds, managing complex structured transactions, and oil and gas mineral law. Mr. Stephens served in senior management and board roles with several public entities including executive vice president, secretary, and general counsel for Plains Resources Inc. and Plains Exploration and Production Company.

His career includes advising and investing with private equity on asset level transactions; Serving on a management team that initiated a corporate restructuring of Plains Resources Inc., an NYSE-listed owner of businesses that included upstream oil and gas assets, midstream oil pipelines, and downstream oil storage terminal assets. The resulting reorganization included the tax-free spinoff of Plains Exploration and Production Co.; Successfully engineering and executing a comprehensive reorganization of an international publicly listed E&P company with interests in Europe and Africa; Serving as a founding director and president of a start-up international exploration company and leading the effort from private to public capitalization and ultimate sale; Developing and managing transactions and capital funding in a merchant banking group within a Fortune 500 energy transportation and trading company, including debt and equity structured components.

In addition to his executive career, Stephens practiced in the areas of corporate and mineral law at Cantey Hanger LLP in Forth Worth.

**Paul Yale**

Mr. Yale is board certified in Oil, Gas and Mineral Law by the Texas Board of Legal Specialization. He worked for 27 years with ExxonMobil Corporation and its predecessor companies at various locations within the United States. His last position was Manager of Land for ExxonMobil’s United States Production Organization with responsibility for ExxonMobil’s land activities in the continental United States both onshore and offshore. Prior positions included International Agreements Coordinator, Natural Gas Commercial Negotiator, Trades and Unitization Supervisor, and Alaska Land Advisor.

Before joining ExxonMobil, Mr. Yale worked in the private law sector engaged in general business law practices with an emphasis on litigation, creditor’s rights, and bankruptcy. Since joining Burleson Cooke, Mr. Yale's practice has been primarily oil and gas title examination and transactional work.

**III. FINANCE**

**Kim Cagle**

Kim Cagle has over 20 years of experience. She focuses her practice on representing commercial banks, financial institutions and borrowers in structuring, negotiating, and documenting financing transactions. Before joining Burleson Cooke, Ms. Cagle was a partner with Mayer Brown in Houston, Texas.

Her experience includes energy lending, leveraged acquisitions, senior and subordinated debt financings; publicly-traded debt instruments; asset-based lending transactions; project financings; letter of credit transactions; derivatives; receivables securitization; and monetization of long-term contracts. She also has a background in leveraged, cross-border, and synthetic leases.
IV. RESTRUCTURING AND BANKRUPTCY

**Tom Henderson**

Mr. Henderson has thirty years of experience in nearly every capacity that plays a role in the reorganization process, including debtors, creditors, bondholders, creditors committees, equity committees, purchasers and investors. He has represented numerous clients across a diverse range of industries including real estate, retail chains, oil and gas companies, manufacturing and agricultural entities, and high tech firms. His clients range in size from individuals to multinational corporations involved in financial difficulties stemming from mass tort issues.

Mr. Henderson’s practice is centered on a wide spectrum of activities—from client consultation and preparation of documents for reorganization to business litigation and negotiation. He has been recognized for his expertise through his certification as a specialist in business bankruptcy by the Texas Board of Legal Specialization (1991) and the American Board of Certification [affiliated with the American Bankruptcy Institute] (1992).

V. REAL ESTATE

**David Livingston**

David Livingston has over 30 years of experience in commercial real estate law, including the restructuring, foreclosure, workouts and bankruptcy issues of the previous real estate downturn. Mr. Livingston represents real estate, banking and other commercial interests in the acquisition, development and financing of raw land, retail shopping centers, office buildings, residential subdivisions, apartments and other multi-family developments, and in the restructuring and/or foreclosure of distressed real estate assets and bankruptcy matters.

Mr. Livingston began his real estate law practice with Reynolds, Allen & Cook in Houston, Texas. He subsequently served as Vice President and General Counsel of Guardian Savings & Loan Association of Houston, a $2 billion association heavily involved in commercial real estate development finance. Mr. Livingston was asked to serve as General Counsel to FIMSA, a First Interstate Bank subsidiary, whose mission was to assess, restructure, manage, and ultimately dispose of over $400 million in distressed real estate assets. Mr. Livingston returned to private practice in 1990. Mr. Livingston is certified as a specialist in commercial real estate by the Texas Board of Legal Specialization.