Time not on the side of struggling oilpatch

By JOHN GRIEVE

The halcyon days of profit and expansion in the oilpatch in Alberta are a fond but distant memory.

How long the depressed market will last is anyone's guess and how much damage it will do is equally unpredictable. There are no doubt bargains to be had for astute investors, but staying the course in the continued depressed market is becoming more and more difficult.

From Calgary to Dallas to Wall Street, lenders have lost their patience and borrowers are feeling the squeeze. With each passing day it is becoming more obvious that oilpatch borrowers will not likely be able to simply wait out a return to a buoyant energy market; they will have to be creative, as will their stakeholders.

I predict there will be more and more protective filings under the Companies' Creditors Arrangement Act, or perhaps the *Canada Business Corporations Act*, as time runs out for borrowers, patience runs out for lenders and the market continues to slump.

Buying runway may be a possible strategy, but if there are continued losses it simply will not work in the long term. "Extend and Pretend" is not working the way it did a year or two ago.

At some point, even if lenders are going to realize a significant loss, their patience reaches an end and they will take steps to recover what they can and move on to more profitable, stable business. This is not something that is unique to the oil market (it happened to the mining industry several years ago and to the automotive industry and the high tech industry before that) and it will have a continuing and significantly detrimental effect on the oil and gas market in Alberta until world prices return to something approaching their pre-slump prime and stabilize there.

Why is Alberta's oilpatch now a briar patch? Primarily world markets. Overproduction and political strife in Africa, South America, the Middle East and Russia have hammered oil prices. There continues to be a glut on the market, and this will continue to keep prices down.

The U.S. Energy Information Administration estimates the price of West Texas intermediate crude oil at a benchmark $52.15 in 2017. Oil hit that price several months ago; and in August it dropped back to below $40 a barrel. Many analysts see oil remaining below $70 a barrel into 2018 and investors in the oil and gas market would be prudent to err on the side of caution. In addition, friction over getting Alberta crude to market through a series of as of yet unapproved pipelines isn't helping things. Neither is the mayhem caused by the Fort Mac fires and now floods.

On the flip side, although the industrialized world's reliance on oil and gas is slowly waning, it is not likely to significantly diminish any time soon and appetite is likely to continue to grow in emerging economies. The profitability of any given oil and gas company depends on its expenses in bringing crude to market. However, $60 a barrel oil is not generally thought of as being profitable in Alberta. Formal oil and gas company insolvencies in Alberta abound and many of the smaller companies have fallen prey to receiverships or liquidations where the lenders, perceiving no end in sight, simply want to move on. This appears to be the case with Calmena Energy Services, Spyglass Resources, Endurance Energy, Parallel Energy, Palliser Oil & Gas, Kinwest 2008 Energy and ATK Oilfield Services to name but a few.

However, the larger players are looking to reorganize, recognizing that value can be

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preserved by keeping the organization together and operating. Thus there have been CCAAs of a number of oil and gas companies (for example, Sanjel Corporation, Connacher Oil and Gas Limited and GasFrac Energy Services) and there will likely be many more.

There are numerous oil and gas companies or service companies in the industry whose credit rating has been downgraded by the rating agencies and appear to be facing very difficult economic times. In recent weeks, a number of relatively significant companies that operate within the Alberta energy market have issued news releases acknowledging defaults. According to *Insolvency Insiders'* watch list form July, these include Twin Butte Energy Ltd., Lightstream Resources Ltd., Questfire Energy Corp., Tesla Exploration Ltd., Target Capital Inc. and many other corporations.

How can this all be turned around? The simple solution, of course, is a sharp rise in world prices. However, we can't count on that. There will, in all likelihood, be a recovery but it will almost certainly be slow. The more realistic solution is patience. Not just patience of lenders, but patience of trade creditors, suppliers, employees, pension funds, regulators and finally, the courts.

How do oilpatch borrowers convince capital lenders to be more patient? The obvious strategies of cost cutting, sale of non-core assets, increased fees and capitalization of interest payments are getting some traction, but not enough. What about normal arm's length creditors? Well, they are suffering too. Employees, landlords, suppliers, service providers and the tax man all need to be paid. Regulators

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simply can't be ignored and the courts have to be educated.

How any given constituent weathers this storm depends entirely on where they sit on the spectrum. New York funds need to answer to their investors and need to have at least the prospect of payment of additional profits when the market returns. Many of them will end up being the owners of these companies as shares are exchanged for debt so that the debtor can react to an expanding market without eating up all their capital through high interest payments.

If there is any hope of preserving value, traditional bank lenders need to be equally patient and need to look at alternative forms of remuneration. Employees will simply have to lower their expectations. Perhaps they too could be offered a stake of some kind in the company. The same goes for suppliers and service providers.

As for the regulator, the recent debacle arising from the *Redwater Energy Corporation* case in which the Alberta Energy Regulator sought to gain priority over first priority secured lenders to fund remediation costs is for abandoned wells was, in this observer's view, the worst way to go about stimulating the market. It is very unfortunate that cash-strapped oil and gas companies cannot afford to remediate their sites, but some of those royalties that have swelled Alberta's coffers over the past decade or more should have been preserved for this purpose rather than picking the pockets of arm's length lenders.

There is no one panacea for the crisis in the Alberta oil and gas industry. Austerity, patience, good luck in the markets and thoughtful focus are all important.

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However, what there is and what has been demonstrated time and time before is the resilience of Albertans. Look no further than Fort McMurray to see what Albertans are capable of. I believe the courts will be equally resilient and patient. The courts are prepared to give substantial debtors a chance to work things out with their stakeholders. The judges of Alberta's court of Queen's Bench have seen this movie before and they know that prices will come back and a scorched earth policy will ultimately help no one.

Expect them to continue to be as patient and thoughtful as they can possibly be, holding creditors at bay for a reasonable length of time to provide breathing space and negotiation room. However, at some point denying the right of secured creditor to realize on its security will have even more disastrous consequences to the Albertan and indeed Canadian economies.

There will be instances of certain participants seeking to profit from this sustained downturn and in some instances that may be entirely appropriate. However, as the old saying goes, "pigs get fat, hogs get slaughtered" and profiteering will not be viewed kindly by the industry or the courts.

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Time will tell where this energy market takes us, but there is cautious optimism that profitability will slowly return and a more mature and sensible market will emerge.

This will not be the last time there is a slump in this or any other commodity market. Let us hope, however, that all the participants in this industry are more measured in their approach to good times and more conservative in their preparation for the bad times, that will inevitably come again.

John Grieve is the leader of Fasken Martineau's global insolvency and restructuring group. His practice is focused on complex commercial reorganizations. His insolvency and restructuring expertise has been recognized in Chambers Global, Euromoney, Best Lawyers in Canada, Who's Who Legal, Lexpert, Benchmark and Martindale Hubbell. Please contact him at jgrieve@fasken.com or 604-631-4772.

Stay true to your culture, long term goals

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inefficiencies/losses of an improperly managed project.

Consider building an advisory board to optimize operations and provide strategic direction.

Stay true to business values and culture. While strategic plans may shift during a downturn, decisions should still reflect long-term goals.

Recognize power of information

Use an enterprise resource planning system to analyze the cost of labour, supply and materials to understand the true cost of doing business.

Adopt CRM software. This will help keep track of customers and to analyze purchasing habits. Anticipate need and customize your product or service accordingly.

Be open about your true cost of doing business. Customers will be more willing to work with you if they understand the correlation between cost and price.

Sales efforts should be focused on management or the owner(s) rather than with procurement, which is typically solely focused on price.

If ever there was a time to be collaborative, innovative, open and agile, it's now. Embrace creativity, partnerships and networks; connect and collaborate with employees and customers; refine processes, efficiencies and technology; take the time to learn and apply that learning to build new and innovative solutions which in turn will drive opportunity.

Don't wait for change. Focus on doing business with companies that value more than the lowest price. Bidding wars only drive the market down further.

Wes Priebe, Grant Thornton Corporate Finance Inc.

Together, oil and gas companies can drive industry-wide change to reduce the effects of pendulum pricing. Now is not the time to do nothing.

Wes Priebe is managing director with Grant Thornton Corporate Finance Inc. in Alberta. He works with mid-market companies in the oil and gas sector, assisting with mergers, acquisitions, divestitures and sourcing capital.