The Impact of Insolvency of a Contracting Party: What Can You Do Under Your Agreement?

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Oil prices stabilizing at around USD 50

Pressure on working capital in the industry is becoming increasingly acute:

- Price reductions demanded by powerful oil companies
- Companies struggling to service loans
- Burdensome expenditure levels for operations
Companies filing for insolvency/bankruptcy

United Kingdom

2010: 4
2015: 28

USA

2015: 44
2016: 61
Different perspectives

Client suspects a counterparty to be in financial distress

Client is the party in financial distress
If a counterparty is suspected to be in financial distress

WATCH
CHECK
ASSESS
PLAN
ACT
REACT
WATCH: Early warning signs

⚠️ Requests for changes in trading terms
⚠️ Difficulty contacting key personnel
⚠️ High staff turnover
⚠️ Breach of performance obligations
⚠️ Contractors and sub-contractors not being paid on time (or at all)
⚠️ Changes in accounting reference dates or late filing of accounts
⚠️ Rumours in the market place
CHECK: Follow up on any suspicions

- Check online sources regularly and make searches at the relevant court
- Ask for information from your counterpart
- Consult your company’s external legal and financial advisers
ASSESS: What are the strengths and weaknesses of your own position?

- Check your contracts
- Consider termination rights
- Confirm outstanding monies your company owes and/or is owed – any right of set-off?
- Consider the impact your business would suffer if the counterparty fails to perform
- If the counterparty is a co-venturer, consider the contractual default provisions and regulatory regime
PLAN: Make a contingency plan

- Identify alternative arrangements your company would need to make
- Ascertain timeline to put such arrangements in place
- Consider a default protocol
- Timing

If a counterparty is suspected to be in financial distress
ACT: Seek extra protection and limit your exposure

- Put pressure on the counterparty to pay
- Get collateral
- Performance bonds and letters of credit
- Parent company guarantees
- Introduce step-in rights
- Asset tracing
- Seek legal and financial advice
REACT: Be proactive when party goes into insolvency

- Make immediate contact with the insolvency practitioner (IP) who has been (or will be) appointed
- Ensure the IP is informed of assets your company is claiming ownership over
- Check deadlines: once a company has been declared bankrupt, the deadlines in proceedings for debt recovery are often short/not extendable
- Appoint a focal point in your company to communicate with the IP
The distressed company’s perspective
First aid

- Cash is paramount
- Credibility is key
- Offer solutions
- Seek advice
Restructuring strategies

- Often the **most valuable asset** is the licence to extract the hydrocarbon
- A **key strategy** will be how to maximise returns from the licence
3 possible approaches:

1) Warehouse the asset

2) Obtain new funding

3) Dispose of the licence (in part or in full)
   a) Sale of the licence (licence assignment) or
   b) Sale of shares in the company holding the licence (change of control)
Specific considerations for joint operating agreements (JOAs)

- In case of default: ultimate sanction is forfeiture
- Many JOAs include a buy-out alternative
- Pre-emption rights
- Government consent
In summary:

- Stay vigilant
- Assess all options
- Regularly re-assess your options
- Protect your rights
Thank you

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