

# FTI CONSULTING ADVISES ON First North Sea casualty of this oil cycle

**In January 2016, Chad Griffin and Lisa Rickelton of FTI Consulting were appointed Joint Administrators over UK companies in the Iona Energy group, an oil and gas Exploration and Production (“E&P”) group with assets in the UK North Sea. Although these administrations are a result of the well-known challenges facing oil and gas companies in the current oil price environment, they are the first UK E&P insolvencies within this oil cycle.**

Given projected prolonged weakness in the commodity price environment, and with very limited sources of funding available, we should expect to see more E&P restructurings and insolvencies over the near-term. This article highlights some of the key issues to be aware of for lenders and investors who are looking at contingency planning and potential insolvencies in distressed UK oil and gas situations.

## Background

Iona Energy ran into difficulties in late 2014, brought on by production problems at its main producing field (Huntington), a delay to the timetable for its key development project (Orlando), a need for additional development funding, a reduction in oil prices and looming decommissioning costs.

In early 2015 FTI Consulting was retained as financial advisor to the bondholders and undertook a review of the business plan and the Orlando development plan, including a technical assessment using our petroleum engineering specialists.

Ultimately, an innovative restructuring was developed, which would have funded the Orlando project development through a farmout, capex savings and deferrals from key Orlando project suppliers and a debt for equity swap to reduce the level of bond debt.

However, in late 2015, the proposed farmout partner pulled out after its parent elected to restrict capital allocation to its upstream operations. Therefore the restructuring could not proceed and focus shifted to realising value through disposals.

The administration strategy involved effecting certain pre-packaged transactions for bids that had been negotiated during the M&A process, winding down operations and exiting from other licence interests where no bids emerged.

## Key Issues

There are some significant industry, regulatory, operational and tax issues to be aware of in undertaking contingency planning on E&P companies, many of which have featured in the case of Iona Energy. We set out some of these below:

### Understanding the assets

E&P companies range from large scale operators of producing oilfields to exploration focussed companies, and their business models are vastly different. A thorough understanding and risk assessment is needed, as it will drive the appropriate strategy.

It is also important to understand each oil licence and their status, royalty entitlements, disproportionate lifting entitlements, operatorships, joint operating agreements, partners, well inventories

and other key items. Key agreements should be reviewed in detail to understand entitlements, defaults and points of leverage.

Particular focus is needed on decommissioning. Decommissioning liabilities are unsecured claims but will be of significant importance to bidders and regulators. An in depth understanding of the development infrastructure in place on the seabed, including suspended wells, is crucial.

## Health and Safety and Emergency Response arrangements

Membership of the Offshore Pollution Liability Association (OPOL), an industry organisation which administers a voluntary strict liability compensation regime, is mandatory for operators of oil licences. This imposes certain obligations on members including financial and operational capability in the event of an emergency pollution incident.

It is important to review insurance arrangements. Specialist energy policies are not covered by standard open cover and it will be important to liaise with the insurers to ensure continuity and availability of cover.

A risk assessment should be undertaken for HSE issues. This is not an area to be overlooked, however low the perceived risk. Key staff with health and safety and emergency response responsibilities should be identified and retained. Certain standby contracts may also be needed to ensure appropriate incident readiness.

## Role of the regulator

From April 2015, UK North Sea oil and gas companies have been regulated by the Oil and Gas Authority (OGA). It is an executive agency of the Department of Energy and Climate Change (DECC).

Early engagement with OGA is important in distressed situations given licence defaults upon insolvency, development obligations and OGA consent requirements for disposals.

The Petroleum Act 1998 affords the Secretary of State wide ranging powers to serve notices on parties in connection with decommissioning and well abandonment. These parties can include group companies, shareholders owning in excess of 50%, former owners and potentially directors and officers.

Specialist E&P legal advice is important in this area. Insolvency practitioners will wish to make appropriate arrangements with OGA and DECC ahead of any insolvency, in particular in relation to potential risks of claims against them for decommissioning and abandonment.

It is important to have an open and constructive dialogue with the OGA. In our experience, OGA is acutely aware of the difficulties facing many struggling oil and gas companies and can play a key role in providing flexibility and support where needed.

## Asset realisation and the importance of tax

With depressed oil prices, disposal processes will prove challenging. It is important to explore upside sharing through deferred consideration to drive superior recoveries.

Most distressed oil and gas companies have significant pools of tax losses. These are typically available to shelter future trading profits on licences but are not capable of being sold separately. It is also key to drive value from these attributes.

Given high corporation tax rates for UK North Sea oil companies, most interested parties look for an acquisition of companies to preserve the tax loss pools, rather than business and assets, which would result in the tax losses being unavailable.

Consequently, efforts should be taken to achieve a financial restructuring that enables the sale of companies as going concerns, meeting the administration first purpose. This may involve a company voluntary arrangement ("CVA") to restructure unsecured creditors' claims in an efficient way. The recent introduction of the Corporate Rescue Exemption may also be of benefit in restructuring secured debt in a tax efficient manner.

With tax being such a large value driver for bidders, it is important to seek tax advice early, to develop a value maximising approach to disposals.

## Optimising the overall outcome

E&P restructurings and insolvencies present a unique set of challenges. Given the benign oil environment in recent years, there are few precedents to follow. It is important to assemble the right team with the requisite experience, who can step up immediately and drive an optimal recovery.

## FTI Consulting Oil and Gas Experience

Over the last 12 months, FTI Consulting has advised management, bank groups, bondholders, unsecured creditors and other stakeholders in the most significant energy related restructurings and turnarounds in recent years. In EMEA, FTI has been particularly active on restructurings in the oil and gas sector with roles spanning financial diligence, technical reviews, contingency planning and insolvency.

We work in all the major producing areas, including US, Europe, sub-Saharan Africa, the Middle East, South America and Asia. Our professionals include former senior energy executives, regulatory officials, petroleum engineers and geologists to support the financial and insolvency skill sets of our restructuring professionals.

If you would like to speak to us about the issues raised here, and what they could mean for you or your clients, please get in touch via the details below.

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## About FTI Consulting

FTI Consulting, Inc. is a global business advisory firm dedicated to helping organisations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. FTI Consulting professionals, who are located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring.

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