

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO**

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| In re: |) | |
| |) | Case No. 17-16046-EEB |
| KINGS PEAK ENERGY, LLC., a Nevada |) | |
| corporation, |) | Chapter 11 |
| |) | |
| Debtor. |) | |
| |) | |

**COVERSHEET FOR DEBTOR'S MOTION FOR EXPEDITED ENTRY OF ORDERS:
(1) FOR AUTHORITY TO USE CASH COLLATERAL; AND (2) TO PAY CRITICAL
VENDOR**

Debtor in the above-captioned Chapter 11 case filed on June 29, 2017, requests the Court to enter the Orders listed below on an expedited basis, pursuant to L.B.R. 2081-1.

DEBTOR SEEKS EXPEDITED ENTRY OF THE FOLLOWING ORDERS:

1. Interim Order Authorizing Debtor's Use of Cash Collateral; and
2. Order Authorizing Payment of Prepetition Claim of Critical Vendor.

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO**

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| In re: |) | |
| |) | Case No. 17-16406-EEB |
| KINGS PEAK ENERGY, LLC, |) | |
| |) | Chapter 11 |
| Debtor. |) | |
| |) | |
| |) | |

**DEBTOR’S MOTION FOR EXPEDITED ENTRY OF ORDERS:
(1) FOR AUTHORITY TO USE CASH COLLATERAL; AND (2) TO PAY CRITICAL
VENDOR**

King’s Peak Energy, LLC (“KPE” or “Debtor”), as the debtor and debtor-in-possession in this chapter 11 case, pursuant to 11 U.S.C. § 363(c)(2) and Federal Rule of Bankruptcy Procedure 4001(b)(1) and Local Bankruptcy Rules 2081-1 and 4001-3, moves (1) for authority to use cash collateral and provide adequate protection to Macquarie Bank Limited (“MBL”), and (2) to pay a critical vendor, and in support thereof states:

Background

1. On June 29, 2017 (the “Petition Date”), KPE filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (“Bankruptcy Code”). No trustee has been appointed. Debtor continues as debtor-in-possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code.

2. As of the date hereof, no creditors' committee has been appointed in this case. In addition, no trustee or examiner has been appointed or applied for.

3. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157(b) and 1334. Venue is proper pursuant to 28 U. S. C. §§ 1408 and 1409. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b).

4. The statutory predicates for the relief requested herein are §§ 361 and 363 of the Bankruptcy Code and Rules 2002 and 4001 of the Federal Rules of Bankruptcy Procedure.

Debtor, Its Assets, and Contract Operator

5. KPE is an independent energy company engaged in the exploration, development, production and sale of crude oil and natural gas in Wyoming and Utah. KPE acquired its oil and gas properties in 2014 from Whiting Petroleum.¹

6. KPE is a Nevada limited liability company. The sole member and manager of KPE is Federico Soliz. KPE's principal place of business is located at 390 Union Boulevard, Suite 620, Lakewood, Colorado. KPE has no employees.

The Assets

7. KPE owns twelve (12) producing wells in five fields in Uinta County Wyoming (the "Wyoming Asset"). KPE owns two (2) active wells in a single field in Summit County, Utah (the "Utah Asset" and together with the Wyoming Asset, the "Assets"). KPE also has two (2) disposal wells in Utah.² The Wyoming Asset and the Utah Asset are located near the Wyoming / Utah border, near Interstate I-80. The vast majority of the Assets sit on federal land. The Assets are unitized and KPE owns a field-weighted average of approximately 96% of the working interests and has a field-weighted average net revenue interest (after royalties and overrides) of approximately 79%.³ The Assets produce approximately 560 BOPD (barrels of oil per day) and 700 MCF (million cubic feet) per day of natural gas.

¹ The factual information in this Motion is set forth in the *Declaration of Federico Soliz* (the "Soliz Declaration"), which is attached as **Exhibit 1**, and the *Declaration of John Teff* (the "Teff Declaration"), which is attached as **Exhibit 2**.

² There are also approximately 14 inactive wells.

³ A list of the leases and wells that are the Wyoming Asset and Utah Asset is attached hereto as **Exhibit 3**. In May 2017, Debtor lost the "Big Spring 15-23" lease because it did not begin development on the leased property.

8. The oil revenue for 2016 attributable to KPE's 96% working interest was approximately \$5,835,000 million. The natural gas revenue for 2016 attributable to KPE's 96% working interest was approximately \$404,000.

9. KPE sells the crude oil produced from the Assets to a single purchaser each month for a price that is the NYMEX WTI crude oil contract price minus \$5.00. KPE sells the natural gas produced from the Assets to a single purchaser at the NYMEX natural gas contract price, less a transportation fee of 12.2%. The oil and gas purchasers pay once per month between the 15th and 21st of the following month. Thus, payment for the June oil and gas sales will be made between the 15th and 21st of July. Because of unitization, royalties, and overriding royalties that reduce KPE's net revenue interest to approximately 79%. When the operator of the fields receives 100% of the sale proceeds, about 21% of that amount belongs and is payable to third parties (non-working interest owners, royalty holders, etc.).

10. The purchaser of the oil and gas is required to remit the sale proceeds to the operator. The operator is required to account for and pay directly to the appropriate party the revenue attributable to third party interests, including taxes. There are penalties and fees that are incurred in the event the operator fails to do so.

11. The Wyoming Asset, the Utah Asset, certain bank deposits, sale proceeds from the oil and gas purchasers held at the purchaser and operator, and money deposited for performance bonds in KPE's name are substantially all of KPE's assets that existed on the Petition Date. Prior to the Petition Date, KPE was a party to certain hedge and swap agreements which have been liquidated in May of 2017, and all the proceeds in the amount of \$2,121,108 were paid to MBL.

The Contract Operator

12. Proven Petroleum, Inc. (“Proven”) is the contract operator of the Wyoming Asset and Utah Asset pursuant to a contract operating agreement, and is the approved operator or record with the states of Wyoming and Utah, the Bureau of Land Management, the U.S. Forest Service, and the Wyoming and Utah Oil and Gas Commissions. As the contract operator, Proven is responsible for managing, developing, supervising, and maintaining oil and gas production from the Assets. Proven supervises all well service operations, well workovers, environmental work, and remedial operations. Proven contracts with the oil and gas purchasers, monitors, verifies, and reports on production, performs all accounting for revenue, taxes, and expenses, pays field vendors and severance, conservation and ad valorem taxes, and complies with regulatory reporting requirements in Wyoming and Utah, Proven sends joint interest billings (detailed monthly reports of property taxes and expenses commonly referred to as “JIBs”) to interest owners and royalty holders. Under the contract operating agreement, Proven is entitled to receive \$50,000 per month for its services.

13. Proven hires local vendors to perform field work. The typical recurring field operating expenses for the Assets total approximately \$270,000 per month. Most field vendors send Proven an invoice throughout the following month for services provided in the prior month. Certain vendors bill for services and equipment in advance.

14. Typically, Proven would pay the field vendors in the ordinary course as the bills came due. Following the end of each month, Proven would compile invoices received during that month and send the JIBs to the interest owners. However, Proven would receive the proceeds for prior month’s production between the 15th and 21st of the month. Proven would then pay a portion of the revenue attributable to the interest and royalty owners and deduct funds from the account

Proven has to directly pay severance and conservation taxes, and would hold an accrued amount for ad valorem taxes.⁴ The interest owners would then later send payment back to Proven for the JIB. Thus, in general, for field work performed in May, Proven would pay the field vendor sometime in June. Proven would send the JIBs in June and receive payment on the JIBs in late June or early July.

15. Pursuant to the cash flow process contemplated by the Credit Facility (as defined below), all funds from the sale of oil and gas from the Assets would be transferred each month from Proven to a KPE project account at MBL, which was controlled by MBL. Each month, MBL would withdraw funds from the project account to pay itself the accrued monthly interest and any fees and costs it had incurred. MBL would then transfer the remainder of the funds to the account maintained by Proven for operating the Assets. It was essentially a cash-sweep loan. Commencing January 2017, payments of amortized principal became mandatory, and MBL would also withdraw funds from the project account to pay itself the appropriate principal payment before transferring the remainder of the funds to Proven's account described above.

16. Neither Mr. Soliz nor KPE have an equity interest in Proven. John Teff does not have an equity interest in KPE, but Mr. Teff is an officer and director of KPE. KPE's principal place of business is the principal place of business of Proven. Mr. Teff is the manager of an unrelated entity, CM Production, LLC, which owns and operates other oil and gas assets that do not involve KPE.

⁴ Severance, conservation and ad valorem taxes are secured by statutory liens against the Assets that prime all other liens, including those of MBL.

Debt Obligations

The Macquarie Bank Limited Credit Facility

17. KPE is a party to a Senior Secured Credit Agreement dated as of November 3, 2014 (as amended, restated or otherwise modified from time to time, the “Credit Facility”) between the Debtor as Borrower, and MBL. The Credit Facility provided for a term loan of up to \$75,000,000 in three tranches. As of June 17, 2017, KPE was indebted to MBL in the amount of \$18,588,079.00, plus interest and attorneys’ fees incurred prior to the Petition Date. The non-default interest rate under the Credit Facility is LIBOR plus 6.0%. The default interest rate is LIBOR plus 9.0%.

18. KPE received advances under the Credit Facility to purchase the Assets in November 2014, to pay lease operating expenses and to fund required collateral for bonds. The purchase price for the Assets before adjustments was approximately \$27,000,000. KPE received a second smaller advance to purchase a small non-operating interest in the Assets after the initial advance. No other advances were made under the Credit Facility.

19. The Credit Facility is secured by substantially all of KPE’s assets, including the Wyoming Asset, the Utah Asset, and performance bonds in KPE’s name. In late 2016, MBL declared an event of default, and, as provided in the Credit Facility, MBL subsequently began charging interest at 9.00% above LIBOR sometime in 2017.

20. CM Production, LLC, guaranteed the Credit Facility up to \$500,000. There are no other guarantors of the Credit Facility. Proven and MBL entered into a Disgorgement Agreement that, in general, required Proven to pay to MBL all of the funds attributable to KPE’s interest in the proceeds from the sale of oil and gas from the Assets to MBL without setoff or

deduction. The disgorgement agreement also provides that any debt KPE owes to Proven is subordinated to KPE's debt to MBL.

Other Debt

21. Nearly all of Debtor's debt arises from operation of the Wyoming Asset and Utah Asset. Debtor owes approximately \$700,000 (through May) for field work performed by vendors hired by Proven. Debtor believes that a majority, if not all, of the vendors would be entitled to claim mechanic's or well liens on the Wyoming Asset and Utah Asset. Debtor is informed that some of the field vendors have filed liens against the Assets.

22. Debtor anticipates scheduling accrued but not yet due and payable severance and conservation taxes and amounts for accrued but not yet due and payable ad valorem taxes based on production.

23. Debtor owes Proven approximately \$1,745,000 for unpaid JIBs, which includes the approximately \$700,000 for field work (through May), approximately \$420,000 for taxes⁵, and approximately \$625,000 for unpaid contract operator fees and vendors other than field vendors through May 2017.

24. Debtor anticipates scheduling four (4) creditors unrelated to production or taxes in the approximate amount of \$250,000 related to audit fees, legal services, and a title opinion.

25. Finally, based on current valuations, Debtor believes that MBL will likely have a general unsecured deficiency claim under the Credit Facility against the Debtor to be determined, but estimated at this time to be approximately \$9,700,000.

⁵ A small portion of this amount is attributable to the other working interest owners.

Events Leading to Bankruptcy

26. Debtor is an exploration and development company; as a result, the value of Debtor's assets and the amount of revenue are directly correlated to the price of natural gas and oil. In June of 2014, the NYMEX WTI crude oil price was more than \$100.00 per barrel. When Debtor purchased the Wyoming Asset and Utah Asset, oil prices had fallen to approximately \$75.00. Oil prices continued to fall to a low of \$29.00 per barrel in February of 2016.

27. The second tranche of funding under the Credit Facility of up to approximately \$2,500,000 was supposed to be available to perform development and well workover work to increase production at the Wyoming Asset and Utah Asset. However, after the sharp fall in oil price, MBL would not advance the money. Debtor anticipated that the development work and well workovers would increase production by 125-250 BOPD. The sharp decrease in oil and natural gas prices drastically reduced Debtor's monthly revenue. The low oil and gas prices combined with not having the additional production from the development and workovers to result in Debtor's revenues being insufficient to pay interest and fees to MBL and the monthly JIBs beginning in November of 2016.

28. In November of 2016, MBL demanded that Debtor engage Bay Capital, an investment banker to market the Assets. Three parties indicated interest and one made an offer for the Assets. Debtor negotiated with the potential purchaser, but things moved slowly and a purchase agreement had not been signed by the Petition Date.

29. Because MBL paid itself before paying monthly JIBs, Proven lacked funds to pay field vendors and taxes. In May of 2017, certain of the field vendors informed Proven that they could not continue to work if payment was not forthcoming. MBL did not authorize or fund

payments to the field vendors at that time. MBL also did not authorize or fund payments to allow Debtor to keep one of its leases, “Big Springs 15-23”, by payment or production.

30. In mid-June, MBL sent notices to the oil and gas purchasers to deliver all sale proceeds directly to MBL, including the funds attributable to other interest and royalty owners. MBL also sent Proven a demand under the Disgorgement Agreement to deliver all funds attributable to KPE’s interest in the Assets. Beginning in June, MBL would not authorize and fund payments to any of the field vendors or for taxes. The gross May gas sale revenue (which includes the revenue attributable to third-party interest and royalty owners) of approximately \$66,000 was delivered to MBL by the purchaser. The gross May oil sales (which includes the revenue attributable to third-party interest and royalty owners) of approximately \$725,0000, is held in suspense by the purchaser.

31. By the end of June, Debtor was very concerned field vendors would stop work. The Assets are located in a very remote location and finding replacement vendors and equipment on short notice would be difficult to impossible. If field vendors stopped working, Debtor believed that production would quickly decrease or, in the case of some vendors stopping work or removing equipment, production would stop. Moreover, MBL indicated it would not fund the required contract payment to Proven as the operator, which left Proven with insufficient funds to pay its own employees, who are essential to operation of Debtor’s Assets. An operator for these Assets cannot be replaced on short notice and the result would almost certainly be severe and damaging disruption of operations. Debtor filed this case to free up funds to pay field vendors and to ensure continued operations in order to preserve the value of the Assets.

Cash Collateral and the Relief Sought by Debtor

32. To continue oil and gas production, Debtor must have use of funds on hand, funds held by others, and funds to be received from the sale of oil and gas. Debtor believes those funds are cash collateral within the meaning of § 363(a) subject to a senior lien in favor of MBL. The cash collateral which Debtor seeks to use is comprised of funds held in various bank accounts in Proven's name as operator at NBH Bank, in KPE's name at MBL, funds held in suspense by the oil purchaser, and its ongoing revenues, along with receivables owed to Debtor (collectively, the "Cash Collateral").

Parties with an Interest in Cash Collateral

33. Pursuant to the Credit Facility, Debtor granted to MBL a security interest in and continuing lien ("Prepetition Liens") on substantially all of Debtor's assets and property ("Prepetition Collateral"), including the Cash Collateral. Debtor believes the Prepetition Liens in the Prepetition Collateral, including the Cash Collateral, are legal, valid, binding, enforceable, non-avoidable and perfected.

34. Field vendors may have a lien on the wells, but no statute provides for a lien on production. Taxing authorities may have an interest in a portion of the Cash Collateral. However, Debtor proposes to pay the taxing authorities amounts that are due and payable.

35. Prior to filing this Motion, Debtor attempted to negotiate with MBL concerning the use of cash collateral and payment of critical vendors. At the time of this Motion, MBL does not consent to the use of cash collateral, and the negotiations continue.

The Budget and Reporting

36. A budget showing estimated receipts and disbursements (the "Budget") for Debtor for the next eight weeks is attached to the proposed order as **Exhibit 1**. Under the proposed

order, Debtor's use of Cash Collateral shall be subject to and governed by the terms of the Budget; provided, however, that: (i) Debtor shall be permitted to exceed the Budget by an amount up to fifteen percent (15%) measured weekly except as to amounts payable to Proven for its operating fees; (b) unused budget amounts for any week may be carried forward; and (ii) Debtor and MBL may agree to exceptional unanticipated expenditures that will not be counted against permitted variance.

37. The Budget shows an anticipated increase in cash from a beginning amount of approximately \$524,000 to \$1,155,000 through the end of August because the Fields operate at a profit before debt service to MBL.

38. The Budget requires some additional explanation because Proven operates the Assets and all payments to field vendors, taxing authorities, and other field expenses will be paid by Proven. The first page of the Budget shows KPE's sources and uses of funds. The "KPE Field Expenses" will be deducted from Proven's account for the Assets to pay field expenses. The "Operator Fee" is payable to Proven. All other expense entries will be paid by KPE directly. The amount in the row titled "KPE Net" for any given week is the same amount as "KPE net revenue" on the first page of the Budget.

39. The third page of the Budget shows the actual field vendors Proven will pay. The "Totals" row shows the total payment Proven anticipates making for the Assets. Because KPE owns approximately 96% of the working interest, the row titled "KPE portion" shows the portion of the total attributable to KPE's 96% working interest. The "KPE portion" on page three is the same amount as the "KPE Field Expenses" on the first page of the Budget.

40. If the Budget is approved and Debtor is permitted to use Cash Collateral, monthly (or more frequently as the Court may require) Proven and Debtor will provide reporting and

underlying documents to MBL to show the payments Proven made directly. Proven and Debtor will also provide to MBL reports of budget to actual revenue and payments by the end of Tuesday for the prior calendar week. Proven agrees to be bound by the terms of any order authorizing the use of cash collateral.

Adequate Protection

41. As adequate protection for the use of Cash Collateral, Debtor proposes to grant MBL replacement liens on all tangible and intangible property of Debtor now existing or hereafter acquired in an amount equal to any actual post-petition diminution in the value of its interest in Debtor's interest in the Prepetition Collateral (the "Adequate Protection Liens"), but only of the same extent, validity and priority as its prepetition liens, all as set forth with more particularity in the proposed order.

42. The Adequate Protection Liens will be subject to any valid, perfected and unavoidable liens existing as of the Petition Date that are senior to MBL's prepetition liens, and any valid and senior liens that may arise or be perfected post-petition under § 546(b).

43. To the extent that the adequate protection described above proves to be insufficient, MBL, shall be granted first priority superpriority administrative expense claims under section 507(b) of the Bankruptcy Code with priority in payment over any other administrative expenses of the kinds specified or ordered pursuant to any provision of the Bankruptcy Code, including, without limitation, sections 105, 326, 328, 330, 331, 503(a), 503(b), 506(c), 507(a), 507(b), 546(c), 726, 1113 and 1114 of the Bankruptcy Code, whether or not such expenses or claims arise in this Chapter 11 case or in any subsequent case or proceedings under the Bankruptcy Code that may result therefrom.

Request for Order Authorizing Payment of Prepetition Claim of Critical Vendor

44. Debtor is seeking authority from the Court to pay the prepetition claim of the critical vendor described below. This critical vendor provides essential and critical services for well operations and its services are essential to maintain the value of the Assets.

45. Debtor has identified one (1) critical vendor at this time, Industrial HP. Industrial HP supplies mechanic's services to the wells and has indicated that it will no longer provide services unless a portion of its prepetition debt is paid. Industrial HP's response times are 24 to 48 hours faster than other providers, and other providers are two to three times the cost. Other providers do not have the level of skill and diligence to be replaced without causing a delay and disruption to well operations. Given that one day of production from a well at 500 barrels a day is \$20,000 of lost revenue, any delay in the provision of these services is costly. Industrial HP does not operate under a long-term contract. The amount owed to Industrial HP totals about \$45,000 as of the Petition Date, but it has indicated that a payment of \$20,000 toward these prepetition balances will induce it to continue to provide services as usual.

46. Critical vendors may be paid prepetition debt. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 985, 197 L. Ed. 2d 398 (2017) (citing *In re Kmart Corp.*, 359 F.3d 866, 872 (7th Cir. 2004)). The generally applied test requires a showing that: (1) paying the critical vendors will benefit the non-preferred creditors; (2) the vendor does not have a long-term contract; and (3) the critical vendor would not continue absent the payment. *In re Kmart Corp.*, 359 F.3d 866, 873 (7th Cir. 2004).

WHEREFORE, Debtor respectfully requests this Court enter an order authorizing the use of cash collateral as provided in the Budget, grant adequate protection replacement liens, permit the payment of a critical vendor, and grant such other relief as the Court deems proper.

Dated: July 10, 2017

Respectfully submitted,

ONSAGER | FLETCHER | JOHNSON, LLC

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