

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION


In re	§	Case No. 17-33626-H5-11
	§	
Deep Operating, LLC,	§	
a Texas Limited Liability Co.	§	
	§	Small Business Case under Chapter 11
Debtor-in-Possession	§	

DEEP OPERATING, LLC, A TEXAS LIMITED LIABILITY COMPANY'S  
DISCLOSURE STATEMENT

DATED 12/07/2017

Dated: 12/7/17

Burger Law Firm

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**[Insert when text is finalized]**

## I. INTRODUCTION

This is the disclosure statement (the "Disclosure Statement") in the small business chapter 11 case of Deep Operating, LLC, a Texas Limited Liability Company (the "Debtor"). This Disclosure Statement contains information about the Debtor and describes the Plan of Reorganization (the "Plan") filed by the Debtor on 12/7/2017. A full copy of the Plan is attached to this Disclosure Statement as Exhibit A. ***Your rights may be affected. You should read the Plan and this Disclosure Statement carefully and discuss them with your attorney. If you do not have an attorney, you may wish to consult one.***

The proposed distributions under the Plan are discussed at pages \_\_\_\_\_ of this Disclosure Statement. General unsecured creditors are classified in Classes 3, 4, and 5, and will receive a distribution of at minimum twenty-five (25%) of their allowed claims, to be distributed as follows: in deferred monthly disbursements from the Debtor's revenues generated by its operations, as well as from recovery of claims and amounts due to the estate.

### A. Purpose of This Document

This Disclosure Statement describes the following:

1. The Debtor and significant events during the bankruptcy case;
2. How the Plan proposes to treat claims or equity interests of the type you hold (i.e., what you will receive on your claim or equity interest if the plan is confirmed);
3. Who can vote on or object to the Plan;
4. What factors the Bankruptcy Court (the "Court") will consider when deciding whether to confirm the Plan;
5. Why Deep Operating, LLC, a Texas Limited Liability Company believes the Plan is feasible, and how the treatment of your claim or equity interest under the Plan compares to what you would receive on your claim or equity interest in liquidation,
6. The effect of confirmation of the Plan.

Be sure to read the Plan as well as the Disclosure Statement. This Disclosure Statement describes the Plan, but it is the Plan itself that will, if confirmed, establish your rights.

### B. Deadlines for Voting and Objecting; Date of Plan Confirmation Hearing

The Court has not yet confirmed the Plan described in this Disclosure Statement. This section describes the procedures pursuant to which the Plan will or will not be confirmed.

#### 1. *Time and Place of the Hearing to Confirm the Plan*

The hearing at which the Court will determine whether to confirm the Plan will take place on \_\_\_\_\_, at \_\_\_\_\_, \_\_\_ m., at the United States Bankruptcy Court for the Southern District of Texas, Houston Division, 515 Rusk, 4th Floor, Courtroom 403

Houston, TX 77002.

2. *Deadline For Voting to Accept or Reject the Plan*

If you are entitled to vote to accept or reject the plan, vote on the enclosed ballot and return the ballot in the enclosed envelope to Burger Law Firm 3000 Wesleyan, Suite 305, Houston, TX 77027. See section IV.A. below for a discussion of voting eligibility requirements. Your ballot must be received by \_\_\_\_\_ or it will not be counted.

3. *Deadline For Objecting to the Adequacy of Disclosure and Confirmation of the Plan*

Objections to this Disclosure Statement or to the confirmation of the Plan must be filed with the Court and served upon Debtor, Deep Operating, LLC and Debtor's Counsel

Burger Law Firm  
3000 Wesleyan, Suite 305  
Houston, TX 77027

by \_\_\_\_\_.

4. *Identity of Person to Contact for More Information*

If you want additional information about the Plan, you should contact John V. Burger Attorney of Record for Debtor.

**C. Disclaimer**

*The Court has not approved this Disclosure Statement as containing adequate information to enable parties affected by the Plan to make an informed judgment about its terms. The Court has not yet determined whether the Plan meets the legal requirements for confirmation, and the fact that the Court has approved this Disclosure Statement does not constitute an endorsement of the Plan by the Court, or a recommendation that it be accepted. The Court's approval of this Disclosure Statement is subject to final approval at the hearing on confirmation of the Plan. Objections to the adequacy of this Disclosure Statement may be filed until \_\_\_\_\_.*

**II. BACKGROUND**

**A. Description and History of the Debtor's Business**

The Debtor is a non-public corporation, an limited liability company formed under the laws of the State of Texas, and was incorporated February 13, 2014; it is a wholly owned subsidiary of Deep Energy

Exploration Partners, LLC, whose principal place of business is located in Houston, Texas.

1. Deep Energy Exploration Partners, LLC

Deep Energy Exploration Partners, LLC buys and/or negotiates the oil, gas, and other mineral leases with mineral estate owners and other companies. Deep Energy Exploration Partners, LLC owns or holds the leases and any assets relating to those leases. Deep Energy Exploration Partners, LLC conducts all required engineering, geological and geophysical services to develop oil, gas and other mineral prospects. Deep Energy Exploration Partners, LLC, however, does not conduct any operations. Once the leases and any asset issues are resolved, Deep Energy Exploration Partners, LLC contracts with Debtor to provide the production of such contracts. These activities are conducted in Texas and Louisiana.

2. Deep Operating, LLC

Debtor, on the other hand, is an approved Texas operator, and conducts all oil and gas operations for Deep Energy Exploration Partners, LLC, as well as other producers in Texas. Debtor contracts with all subcontractors for the exploration, drilling, and production operations. Debtor also secures all services related to state regulatory permitting requirements for the drilling and producing of oil and gas wells. However, Debtor does not hold or own the mineral estates or the relevant leases for such oil and gas production. Debtor also researches the status of the mineral estate and surface estate ownership, and negotiates any easements or rights-of-way with the mineral and/or surface owners.

In connection with Debtor's oil and gas operations, Debtor drilled five (5) wells, initially targeted for a depth of 1,200 feet, in Rockdale Minerva Field commonly known as "Sleeping Giant". This field is located in Milam County, Texas, and contains over one thousand wells, serviced by other operators not related to Debtor. The first well was drilled to a depth of 1,500 feet; the second well was drilled to a depth of 1,750 feet, and the last three wells were drilled to a depth of 2,500 feet. The decision to deepen the subsequent wells below the original objective was because the first well identified potential productive sands, which encouraged Debtor to drill to the deeper depths of 1,500 to 2,500 feet. Consequently, the appearance of significantly larger oil and gas reserves could be recovered from the deeper sands or reservoirs. However, the costs associated with deepening the wells was much greater than originally projected or anticipated; additionally, the planned completion operations failed due to a subcontractor's ability to perform its contracted-for services as required.

Herman J. Schellstede & Associates, Inc. ("Schellstede"), the subcontractor, did not utilize equipment as agreed upon, and the untested equipment it used was insufficient and inadequate; Debtor maintains that the subcontractor did not advise Debtor of its intent to use unproven completion method. Upon information and belief, the subcontractor's services and costs related to such services were to be borne by the subcontractor, and the subcontractor would earn a five (5.0%) percent working interest in the project. This caused Debtor to incur approximately \$300,000 in unexpected costs, in addition to requiring Debtor to obtain another subcontractor to correct and finish the previous subcontractor's faulty and inadequate work. Subsequent to that, the subcontractor's partner, Circle B Exploration, committed to assume the five (5.0%) working interest in the project and pay the costs associated with such five (5.0%)

percent working interest in the project. Even though Debtor had incurred the unexpected costs associated with the subcontractor's services, Circle B Exploration assumed the obligation to pay for five (5.0%) percent working interest share of all previous drilling and future completion costs associated with the project. The subcontractor's partner, Circle B Exploration, failed to comply with its obligations. As a result of Schellstede's breach of contract, Debtor suffered losses and overruns in excess of \$700,000, which includes Schellstede's invoices of \$389,000, the costs for equipment to support Schellstede's services and Schellstede's partner's services. Circle B Exploration received an invoice in the amount of \$188,198.32, which Circle B Exploration has refused to pay. That invoice remains unpaid.

The unexpected costs associated with Schellstede's failure to honor its obligations resulted in significant financial hardship for the Debtor. For instance, Debtor had to expend more funds to other companies to provide necessary equipment and services to complete work Schellstede should have performed. Eventually, Debtor simply did not have the financial strength to continue operations at the same time as covering for Schellstede's incompetent work. This caused Debtor to fall behind with other subcontractors and service providers. Some of Debtor's service providers either threatened to, or actually did, file mechanics and materialmen's liens against Debtor's projects. To the best of Debtor's knowledge, at least three subcontractors have filed lien affidavits in Milam County, Texas for unpaid invoices, which totals approximately \$216,788.00, at least one of which was filed after Debtor filed for relief under Chapter 11 of the Bankruptcy Code. Debtor also fell behind on its payroll obligations to the Internal Revenue Service, and owes approximately \$49,667.00 in such taxes; the IRS caused a federal tax lien to be filed against Debtor's assets in Harris County, Texas.

Debtor sought to reorganize its operations by reducing costs; however, such actions were not successful. Debtor exhausted all efforts on the deeper wells, and concentrated on the shallower zones to rehabilitate its affairs. Debtor had to rely on Deep Energy Exploration Partners, LLC, its parent company, for support. Deep Energy Exploration Partners, LLC has an interest in a project in St. Martin Parish, Louisiana, commonly known as "Arnaudville Field Area". Deep Energy Exploration Partners, LLC attempted to sell its interest in that project and infuse capital into the Debtor. However, such attempts have not been successful and, eventually, Debtor was forced to seek relief under Chapter 11 of the Bankruptcy Code.

Since filing for Chapter 11 Bankruptcy on June 8, 2017, Debtor has been in possession of its assets as a debtor-in-possession. Debtor's plan will consist of selling its interests in some of its assets, as well as collecting amounts due to it from its oil and gas projects. Debtor anticipates that it should be able to generate sufficient revenue to pay a substantial dividend to unsecured creditors.

**B. Insiders of the Debtor**

Insider Name: John Mecom, III	Relationship to the Debtor: President
Compensation paid by the Debtor or its affiliates to this insider during the two years prior to the commencement of the Debtor's bankruptcy case:  Mr. Mecom has received \$92,223.00 as compensation from Debtor during the two years prior to filing. Additionally, Mr. Mecom received \$100,000 within the year prior to filing.	
Compensation paid during the pendency of this chapter 11 case: Mr. Mecom has not received any compensation during the pendency of this case.	

Insider Name: Javier Arellano	Relationship to the Debtor: Chief Executive Officer
Compensation paid by the Debtor or its affiliates to this insider during the two years prior to the commencement of the Debtor's bankruptcy case:  Mr. Arellano received \$\$69,940.00 as compensation from Debtor during the two years prior to filing.	
Compensation paid during the pendency of this chapter 11 case: Mr. Arellano has not received any compensation during the pendency of this case.	

Insider Name: Deep Energy Exploration Partners, LLC	Relationship to the Debtor: 100% Membership interest holder
Compensation paid by the Debtor or its affiliates to this insider during the two years prior to the commencement of the Debtor's bankruptcy case: Deep Energy Exploration Partners, LLC not received any funds as compensation from Debtor during the two years prior to filing.	
Compensation paid during the pendency of this chapter 11 case: Deep Energy Exploration Partners, LLC has not received any compensation during the pendency of this case.	

Insider Name: Spike Trust Consulting	Relationship to the Debtor: Consultant
Compensation paid by the Debtor or its affiliates to this insider during the two years prior to the commencement of the Debtor's bankruptcy case: Spike Trust Consulting received \$173,000.00 as compensation from Debtor during the two years prior to filing for consulting services for such compensation.	
Compensation paid during the pendency of this chapter 11 case: Spike Trust Consulting has not received any compensation during the pendency of this case.	

**C. Management of the Debtor Before and During the Bankruptcy**

During the two years prior to the date on which the bankruptcy petition was filed, the officers, directors, managers or other persons in control of the Debtor (collectively the "Managers") were:

Javier Arellano acted as Chief Executive Officer. John Mecom, III, acted as President.

The Managers of the Debtor during the Debtor's chapter 11 case have been:

Javier Arellano has agreed as the party responsible for ensuring Debtor's compliance during the pendency of this case.

After the effective date of the order confirming the Plan, the directors, officers, and voting trustees of the Debtor, any affiliate of the Debtor participating in a joint Plan with the Debtor, or successor of the Debtor under the Plan (collectively the "Post Confirmation Managers"), will be:

Javier Arellano will continue to serve as the reorganized Debtor's Chief Executive Officer, and John Mecom, III, will serve as the reorganized Debtor's President. Messrs. Arellano and Mecom will continue to effectuate the terms of the Plan, and they will be compensated for services rendered out of revenues generated from production and/or collection of receivables due to the Debtor.

**D. Events Leading to Chapter 11 Filing**

**1. Sleeping Giant, Milam County, Texas, Oil and Gas Operations.**

As stated above, Debtor is an oil and gas operating company. It was responsible for the drilling and completion in wells in oil fields in Texas, primarily in Milam County, Texas commonly known as "Sleeping Giant". Debtor's sole interest in the field derives from the Model Joint Operating Agreement between Debtor, PPV Energy, LLC, and Deep Energy Exploration Partners, LLC. A decline in oil and gas prices in the marketplace, along with Schellstede's failure to honor its contractual obligations resulted in Debtor suffering significant losses in this project.

**2. Arnaudville Field Area, St. Martin Parish, Louisiana.**

Debtor was also the main operator in an oil and gas prospect located in Arnaudville Field Area, St. Martin Parish, Louisiana. Debtor does not own the mineral estate in this project; its interest is to receive \$12,500 in monthly revenue to operate the initial well. Prior to the filing of the bankruptcy case, Debtor had been attempting to sell its interest in this field. Debtor believes, that when oil and gas wells are complete and production begins, Debtor will receive approximately \$12,500.00 per month in revenues when wells are completed.



**E. Significant Events During the Bankruptcy Case**

Debtor has continued to manage its affairs in connection with the Chapter 11 bankruptcy filing.

**F. Projected Recovery of Avoidable Transfers**

Debtor believes there are bases in fact and law to avoid the mechanic's and materialmen's lien affidavits filed against Sleeping Giant in Milam County, Texas. For instance, one of the lien affidavits filed by ARS Contracting, LLC in the amount of \$43,329.00 is incorrect. Debtor asserts that the fees charged by ARS Contracting, LLC are excessive for the services provided and the results obtained. As this lien was filed within two (2) years of the bankruptcy filing, it may be subject to avoidance.

The Debtor has not yet completed its investigation with regard to prepetition transactions. If a creditor received a payment or other transfer within 90 days of the bankruptcy, or other transfer avoidable under the Code, the Debtor may seek to avoid such transfer.

**G. Claims Objections**

Except to the extent that a claim is already allowed pursuant to a final non-appealable order, the Debtor reserves the right to object to claims. Therefore, even if your claim is allowed for voting purposes, you may not be entitled to a distribution if an objection to your claim is later upheld. The procedures for resolving disputed claims are set forth in Article V of the Plan.

**H. Current and Historical Financial Conditions**

The identity and fair market value of the estate's assets are listed in the Debtor's bankruptcy schedules of assets on file in this case. Debtor's best estimate of revenue will derive from operating fees pursuant to the Model Joint Operating Agreements.

The Debtor has not issued a recent financial statement. Debtor's assets and debts are set forth in the Debtors Schedules of Assets and Liabilities on file in this case, along with the Debtor's Statement of Financial Affairs on file herein.

The most recent post-petition operating report filed since the commencement of the Debtor's bankruptcy case are set forth in Exhibit A. A summary of the Debtor's periodic operating reports filed since the commencement of the Debtor's bankruptcy case is set forth in Exhibit A.

**III. SUMMARY OF THE PLAN OF REORGANIZATION AND TREATMENT OF CLAIMS AND EQUITY INTERESTS**

**A. What is the Purpose of the Plan of Reorganization?**

As required by the Code, the Plan places claims and equity interests in various classes and

describes the treatment each class will receive. The Plan also states whether each class of claims or equity interests is impaired or unimpaired. If the Plan is confirmed, your recovery will be limited to the amount provided by the Plan.

## B. Unclassified Claims

Certain type of claims are automatically entitled to specific treatment under the Code. They are not considered impaired, and holders of such claims do not vote on the Plan. They may, however, object if, in their view, their treatment under the Plan does not comply with that required by the Code. As such, the Plan Proponent has *not* placed the following claims in any class:

### 1. *Administrative Expenses*

Administrative expenses are costs or expenses of administering the Debtor's chapter 11 case which are allowed under § 507(a)(2) of the Code. Administrative expenses also include the value of any goods sold to the Debtor in the ordinary course of business and received within 20 days before the date of the bankruptcy petition. The Code requires all administrative expenses be paid on the effective date of the Plan, unless a particular claimant agrees to a different treatment.

The following chart lists the Debtor's estimated administrative expenses, and their proposed treatment under the Plan:

Type:	Basis for Priority	Treatment
Burger Law Firm	11 USC § 507(a)(2)	In Cash, subject to court approval
United States Trustee	11 USC § 507(a)(1)	In Cash

### 2. *Priority Tax Claims*

Priority tax claims are unsecured income, employment, and other taxes described by § 507(a)(8) of the Code. Unless the holder of such a § 507(a)(8) priority tax claim agrees otherwise, it must receive the present value of such claim, in regular installments paid over a period not exceeding 5 years from the order of relief.

The following chart lists the Debtor's estimated § 507(a)(8) priority tax claims and their proposed treatment under the Plan:

Description	Amount	Assessment Date	Treatment
1. Internal Revenue Service	\$49,662	2016; liens filed	Deferred monthly payments with interest at six percent
2. Texas Workforce Comm.	\$9,671.	Unknown	File returns; no liability for

periods asserted.

**C. Classes of Claims and Equity Interests**

The following are the classes set forth in the Plan, and the proposed treatment that they will receive under the Plan:

1. *Classes of Secured Claims*

Allowed Secured Claims are claims secured by property of the Debtor's bankruptcy estate (or that are subject to setoff) to the extent allowed as secured claims under § 506 of the Code. If the value of the collateral or setoffs securing the creditor's claim is less than the amount of the creditor's allowed claim, the deficiency will [be classified as a a general unsecured claim].

The following chart lists all classes containing Debtor's secured prepetition claims and their proposed treatment under the Plan:

<b>Class #</b>	<b>Description</b>	<b>Insider? (Yes or No)</b>	<b>Impairment</b>	<b>Treatment</b>
1	H&V Equipment Svcs.	No	Yes	Debtor will object to the Claim. Debtor did not do business directly with this entity. Debtor will seek to avoid any liens filed against its interest in any property.
1	ARS Contracting, LLC	No	Yes	Avoid lien; remainder is general unsecured claim
1	Mesa Southern Well Servicing	No	Yes	Avoid lien; remainder is general unsecured claim
1	Radial Drilling Services, Inc.	No	Yes	Avoid lien; remainder is general unsecured claim
1	Diamond P Lease and Well Services	No.	Yes	Avoid lien; remainder is general unsecured claim
1	Internal Revenue Service	No	Yes	Pay interest on claim secured by Debtor's assets; balance is priority

## 2. Classes of Priority Unsecured Claims

Certain priority claims that are referred to in §§ 507(a)(1), (4), (5), (6), and (7) of the Code are required to be placed in classes. The Code requires that each holder of such a claim receive cash on the effective date of the Plan equal to the allowed amount of such claim. However, a class of holders of such claims may vote to accept a different treatment. In this case, there are no such claims.

The following chart lists all classes containing claims under §§ 507(a)(1), (4), (5), (6), and (a)(7) of the Code and their proposed treatment under the Plan:

Class #	Description	Impairment	Treatment
N/A	N/A	N/A	N/A

## 3. Classes of General Unsecured Claims

General unsecured claims are not secured by property of the estate and are not entitled to priority under § 507(a) of the Code.

The following identifies the Plan's proposed treatment of general unsecured claims:

General Unsecured Creditors: Class 3  
 General Unsecured Claims of Insiders: Class 4  
 General Unsecured Claims of Equity Holders: Class 5

Class #	Description	Impairment	Treatment
3	General Unsecured Claims and Claims not Secured by Equity in Debtor's Assets	Yes	Projected payment of 25% of unsecured claims, derived from collecting overdue obligation due to the Debtor.
4	General Unsecured Claims of Insiders	Yes	Will only receive distributions if all allowed unsecured claims are paid in full.
5	General Unsecured Claims of Equity Holders	Yes	Will retain their interests in equity in reorganized Debtor.

## 4. Classes of Equity Interest Holders

Equity interest holders are parties who hold an ownership interest (i.e., equity interest) in the Debtor. In a corporation, entities holding preferred or common stock are equity interest holders. In a partnership, equity interest holders include both general and limited partners. In a limited liability company ("LLC"), the equity interest holders are the members. Finally, with respect to an individual who is a debtor,

the Debtor is the equity interest holder.

The following chart sets forth the Plan's proposed treatment of the class of equity interest holders: [There may be more than one class of equity interests in, for example, a partnership case, or a case where the prepetition debtor had issued multiple classes of stock.]

<b>Class #</b>	<b>Description</b>	<b>Impairment</b>	<b>Treatment</b>
5	General Unsecured Claims of Equity Holders	Yes	Will retain their interests in equity in reorganized Debtor.

**D. Means of Implementing the Plan**

1. *Source of Payments*

Payments and distributions under the Plan will be funded by the following:

Debtor intends to fund the plan by the following means:

a. Texas Railroad Commission Services Bond. Debtor has posted a \$50,000 servicer's cash bond with the Texas Railroad Commission. Debtor will withdraw its servicer's bond and obtain release of the funds. Upon information and belief, Debtor believes it does not need the servicer's bond to continue its operations as an oil and gas company.

b. Debtor will collect on accounts receivable owed to it. The funds recovered will be used to satisfy obligations under the Plan.

2. *Post-confirmation Management*

The Post-Confirmation Managers of the Debtor, and their compensation, shall be as follows:

<b>Name</b>	<b>Affiliations</b>	<b>Insider (yes or no)?</b>	<b>Position</b>	<b>Compensation</b>
Javier Arellano	Deep Energy Exploration Partners, LLC	Yes	Chief Executive Officer	0.00
John Mecom, III	Deep Energy Exploration Partners, LLC	Yes	President	0.00

**E. Risk Factors**

The proposed Plan has the following risks:

Risk factors include the fluctuation of oil and gas prices, as well as the inherent risks of drilling operations. Debtor believes that there are sufficient quantities of oil and gas reserves in the oil fields based on Debtor's seismic data; however, there is always a risk that the wells may not produce at the levels anticipated.

Further risks include any claims, defenses, and/or offsets asserted by parties in interest against the demands Debtor will make. For instance, a creditor may claim that Debtor's causes of action are not recoverable or have no value. Likewise, entities owing funds to Debtor may not have the ability to pay what is owed and there may be no assets available to secured Debtor's claim.

**F. Executory Contracts and Unexpired Leases**

The Plan lists all executory contracts and unexpired leases that the Debtor will assume under the Plan. Assumption means that the Debtor has elected to reject the following obligations under the Model Joint Operating Agreement between, Debtor, PPV Energy, LLC, and Deep Energy Exploration Partners LLC; dated May 6, 2016. The Plan also lists how the Debtor will cure and compensate the other party to such contract or lease for any such defaults.

If you object to the assumption of your unexpired lease or executory contract, the proposed cure of any defaults, or the adequacy of assurance of performance, you must file and serve your objection to the Plan within the deadline for objecting to the confirmation of the Plan, unless the Court has set an earlier time.

All executory contracts and unexpired leases that are not listed in Exhibit 5.1 will be rejected under the Plan. Consult your advisor or attorney for more specific information about particular contracts or leases.

If you object to the rejection of your contract or lease, you must file and serve your objection to the Plan within the deadline for objecting to the confirmation of the Plan.

***The Deadline for Filing a Proof of Claim Based on a Claim Arising from the Rejection of a Lease or Contract is \_\_\_\_\_.*** Any claim based on the rejection of a contract or lease will be barred if the proof of claim is not timely filed, unless the Court orders otherwise.

**G. Tax Consequences of Plan**

***Creditors and Equity Interest Holders Concerned with How the Plan May Affect Their Tax Liability Should Consult with Their Own Accountants, Attorneys, And/Or Advisors.***

## **1. Introduction.**

The following discussion summarizes certain significant U.S. federal income tax consequences of the transactions that are described herein and in the Plan that affect holders of Claims or Interests and the Debtor. This summary is based upon the Internal Revenue Code of 1986, as amended (the "Tax Code"), the Treasury Department regulations promulgated thereunder (the "Treasury Regulations"), judicial authority and current administrative rulings and practice now in effect. These authorities are all subject to change at any time by legislative, judicial or administrative action, and such change may be applied retroactively in a manner that could adversely affect holders of Claims or Interests and the Debtor. The federal income tax consequences to any particular holder of a Claim or Interests may be affected by matters not discussed below. For example, the impact of the Plan under any foreign, state or local law is not discussed. Further, this summary generally does not address the tax consequences to Claim holders who may have acquired their Claims from the initial holders nor does it address the tax considerations applicable to Claim holders or Interest holders that may be subject to special tax rules such as financial institutions, insurance companies, dealers in securities or currencies, tax exempt organizations or taxpayers subject to the alternative minimum tax. To the extent that the summary of payments to Claimholders in this section conflicts with other parts of this Disclosure Statement or the Plan, the discussion in such other parts of the Disclosure Statement or the Plan shall govern.

NO RULING WILL BE SOUGHT FROM THE INTERNAL REVENUE SERVICE (the "IRS"), AND NO OPINION OF COUNSEL HAS BEEN OR WILL BE SOUGHT, WITH RESPECT TO ANY OF THE TAX ASPECTS OF THE PLAN. THE DISCUSSION SET FORTH BELOW IS FOR GENERAL INFORMATION ONLY. THIS DESCRIPTION DOES NOT COVER ALL ASPECTS OF FEDERAL INCOME TAXATION THAT MAY BE RELEVANT TO THE DEBTOR OR HOLDERS OF CLAIMS OR INTERESTS. EACH CLAIM AND INTEREST HOLDER IS URGED TO CONSULT WITH ITS OWN TAX ADVISER REGARDING THE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF THE PLAN.

## **2. Federal Income Tax Consequences to Debtor.**

Generally, a taxpayer recognizes cancellation of indebtedness ("COD") income upon satisfaction of its outstanding indebtedness for less than its adjusted issue price. The amount of COD income is, in general, the excess of (i) the adjusted issue price of the indebtedness satisfied, over (ii) the issue price of any new indebtedness issued by the taxpayer, the amount of cash and the fair market value of any other consideration (including stock of the taxpayer) given in exchange for the indebtedness satisfied. However, COD income is not included in gross income to a debtor if the discharge occurs in a Title 11 case or the discharge occurs when the debtor is insolvent. Rather the debtor generally must, after determining its tax for the taxable year of discharge, reduce its net operating losses ("NOL(s)") and any capital loss carryovers first and then, as of the first day of the next taxable year, reduce the tax basis of its assets by the amount of COD income excluded from gross income by this exception. The Debtor does not expect there to be any tax effect to the Debtor as a result of the Plan.

## **3. Consequences to Holders of Claims.**

The federal income tax consequences of the implementation of the Plan to a holder of a Claim

will depend, among other things, upon the origin of the holder's Claim, when the holder's Claim becomes an Allowed Claim, when the holder receives payment in respect of such Claim, whether the holder reports income using the accrual or cash method of accounting, whether the holder has taken a bad debt deduction or worthless security deduction with respect to such Claim and whether the holder's Claim constitutes a "security" for federal income tax purposes. Generally, a holder of an Allowed Claim will realize gain or loss on the exchange under the Plan of its Allowed Claim for stock and other property (such as Cash and new debt instruments), in an amount equal to the difference between (i) the sum of the amount of any Cash, the issue price of any debt instrument, and the fair market value on the date of the exchange of any other property received by the holder (other than any consideration attributable to a Claim for accrued but unpaid interest) and (ii) the adjusted basis of the Allowed Claim exchanged therefor (other than basis attributable to accrued but unpaid interest previously included in the holder's taxable income). The treatment of accrued but unpaid interest and amounts allocable thereto varies depending on the nature of the holder's claim and is discussed below. Whether or not such realized gain or loss will be recognized (i.e., taken into account) for federal income tax purposes will depend in part upon whether such exchange qualifies as a recapitalization or other "reorganization" as defined in the Tax Code, which may in turn depend upon whether the Claim exchanged is classified as a "security" for federal income tax purposes. The term "security" is not defined in the Tax Code or in the Treasury Regulations. One of the most significant factors considered in determining whether a particular debt instrument is a security is the original term thereof. In general, the longer the term of an instrument, the greater the likelihood that it will be considered a security. As a general rule, a debt instrument having an original term of 10 years or more will be classified as a security, and a debt instrument having an original term of fewer than five years will not. Debt instruments having a term of at least five years but less than 10 years are likely to be treated as securities, but may not be, depending upon their resemblance to ordinary promissory notes, whether they are publicly traded, whether the instruments are secured, the financial condition of the debtor at the time the debt instruments are issued and other factors. Each holder of an Allowed Claim should consult his or her own tax advisor to determine whether his or her Allowed Claim constitutes a security for federal income tax purposes.

The Debtor and/or Trustee of the Liquidating Trust intends to take the position that all payments in respect of Allowed Claims will be first allocated to the principal amount of the Allowed Claim, with any excess allocated to accrued unpaid interest. However, there is no assurance that such allocation would be respected by the IRS for federal income tax purposes. In general, to the extent any amount received by a holder of an Allowed Claim is received in satisfaction of accrued interest during its holding period, such amount will be taxable to the holder as interest income (if not previously included in the holder's gross income). Conversely, a Holder generally will recognize a deductible loss to the extent any accrued interest claimed was previously included in gross income and is not paid in full. Each holder of an Allowed Claim is urged to consult its tax advisor regarding the allocation of consideration and deductibility of unpaid interest for tax purposes. A holder, who, under his accounting method, was not previously required to include in income, accrued but unpaid interest attributable to its existing Claims, and who exchanges its interest Claim for cash, or other property, pursuant to the Plan will be treated as receiving ordinary interest income to the extent of any consideration so received allocable to such interest, regardless of whether that holder realizes an overall gain or loss as a result of the exchange of its existing Claims.

Allowed Claims will be paid from the operating income of the Newly Reorganized Debtor. A claimholder's tax basis in a Claim should generally equal the amount included in income as a result



of the provision of goods or services to the debtor, except to the extent that a bad debt loss had previously been claimed. The gain or loss should be capital gain or loss under Section 1221 of the Tax Code to the extent that the Claim did not arise in the ordinary course of trade or business for services rendered or from the sale of inventory to the Debtor, in which case such gain or loss should generally be ordinary. Any capital gain or loss recognized by a holder of a Claim should be long-term capital gain or loss with respect to Claims held for more than one year.

#### **4. Withholding and Reporting.**

The Newly Reorganized Debtor will withhold all amounts required by law to be withheld and will comply with all applicable reporting requirements of the Tax Code. Under the Tax Code, interest, dividends and other “reportable payments” may under certain circumstances be subject to “backup withholding” at a rate equal to the fourth lowest rate of tax under Section 1(c) of the Tax Code. Backup withholding generally applies if the Holder (i) fails to furnish his social security number or other taxpayer identification number (“TIN”), (ii) furnishes an incorrect TIN, (iii) fails to report interest or dividends or (iv) under certain circumstances fails to provide a certified statement, signed under penalty of perjury, that the TIN provided is his correct number and the Holder is not subject to backup withholding. Your ballot contains a place to indicate your TIN.

AS INDICATED ABOVE, THE FOREGOING IS INTENDED TO BE A SUMMARY ONLY AND NOT A SUBSTITUTE FOR CAREFUL TAX PLANNING WITH A TAX PROFESSIONAL. THE FEDERAL, STATE AND LOCAL TAX CONSEQUENCES OF THE PLAN ARE COMPLEX AND, IN SOME CASES, UNCERTAIN. ACCORDINGLY, EACH HOLDER OF A CLAIM OR INTEREST IS STRONGLY URGED TO CONSULT WITH HIS OR HER OWN TAX ADVISER REGARDING THE FEDERAL, STATE AND LOCAL TAX CONSEQUENCES OF THE PLAN WITH RESPECT TO THAT ENTITY.

#### **IV. CONFIRMATION REQUIREMENTS AND PROCEDURES**

To be confirmable, the Plan must meet the requirements listed in §§ 1129(a) or (b) of the Code. These include the requirements that: the Plan must be proposed in good faith; at least one impaired class of claims must accept the plan, without counting votes of insiders; the Plan must distribute to each creditor and equity interest holder at least as much as the creditor or equity interest holder would receive in a chapter 7 liquidation case, unless the creditor or equity interest holder votes to accept the Plan; and the Plan must be feasible. These requirements are not the only requirements listed in § 1129, and they are not the only requirements for confirmation.

##### **A. Who May Vote or Object**

Any party in interest may object to the confirmation of the Plan if the party believes that the requirements for confirmation are not met.

Many parties in interest, however, are not entitled to vote to accept or reject the Plan. A creditor or equity interest holder has a right to vote for or against the Plan only if that creditor or equity interest holder has a claim or equity interest that is both (1) allowed or allowed for voting purposes and (2)

impaired.

In this case, the Plan Proponent believes that Classes 1 through 5 are impaired and that holders of claims in each of these classes are therefore entitled to vote to accept or reject the Plan. The Plan Proponent believes that there are no unimpaired classes and that holders of claims in each of these classes, therefore, do not have the right to vote to accept or reject the Plan.

1. *What Is an Allowed Claim or an Allowed Equity Interest?*

Only a creditor or equity interest holder with an allowed claim or an allowed equity interest has the right to vote on the Plan. Generally, a claim or equity interest is allowed if either (1) the Debtor has scheduled the claim on the Debtor's schedules, unless the claim has been scheduled as disputed, contingent or unliquidated, or (2) the creditor has filed a proof of claim or equity interest, unless an objection has been filed to such proof of claim or equity interest. When a claim or equity interest is not allowed, the creditor or equity interest holder holding the claim or equity interest cannot vote unless the Court, after notice and hearing, either overrules the objection or allows the claim or equity interest for voting purposes pursuant to Rule 3018(a) of the Federal Rules of Bankruptcy Procedure.

***The deadline for filing a proof of claim in this case was October 25, 2017.***

2. *What Is an Impaired Claim or Impaired Equity Interest?*

As noted above, the holder of an allowed claim or equity interest has the right to vote only if it is in a class that is *impaired* under the Plan. As provided in § 1124 of the Code, a class is considered impaired if the Plan alters the legal, equitable, or contractual rights of the members of that class.

3. *Who is Not Entitled to Vote*

The holders of the following five types of claims and equity interests are *not* entitled to vote:

holders of claims and equity interests that have been disallowed by an order of the Court;

holders of other claims or equity interests that are not "allowed claims" or "allowed equity interests" (as discussed above), unless they have been "allowed" for voting purposes.

holders of claims or equity interests in unimpaired classes;

holders of claims entitled to priority pursuant to §§ 507(a)(2), (a)(3), and (a)(8) of the Code; and

holders of claims or equity interest in classes that do not receive or retain any value under the Plan;

administrative expenses.

***Even If You Are Not Entitled to Vote on the Plan, You Have a Right to Object to the Confirmation of the Plan and to the Adequacy of the Disclosure Statement.***

4. *Who Can Vote in More Than One Class*

A creditor whose claim has been allowed in part as a secured claim and in part as an unsecured claim, or who otherwise hold claims in multiple classes, is entitled to accept or reject a Plan in each capacity, and should cast one ballot for each claim.

**B. Votes Necessary to Confirm the Plan**

If impaired classes exist, the Court cannot confirm the Plan unless (1) at least one impaired class of creditors has accepted the Plan without counting the votes of any insiders within that class, and (2) all impaired classes have voted to accept the Plan, unless the Plan is eligible to be confirmed by "cram down" on non-accepting classes, as discussed later in Section [B.2].

1. *Votes Necessary for a Class to Accept the Plan*

A class of claims accepts the Plan if both of the following occur: (1) the holders of more than one-half (1/2) of the allowed claims in the class, who vote, cast their votes to accept the Plan, and (2) the holders of at least two-thirds (2/3) in dollar amount of the allowed claims in the class, who vote, cast their votes to accept the Plan.

A class of equity interests accepts the Plan if the holders of at least two-thirds (2/3) in amount of the allowed equity interests in the class, who vote, cast their votes to accept the Plan.

2. *Treatment of Nonaccepting Classes*

Even if one or more impaired classes reject the Plan, the Court may nonetheless confirm the Plan if the nonaccepting classes are treated in the manner prescribed by § 1129(b) of the Code. A plan that binds nonaccepting classes is commonly referred to as a "cram down" plan. The Code allows the Plan to bind nonaccepting classes of claims or equity interests if it meets all the requirements for consensual confirmation except the voting requirements of § 1129(a)(8) of the Code, does not "discriminate unfairly," and is "fair and equitable" toward each impaired class that has not voted to accept the Plan.

***You should consult your own attorney if a "cramdown" confirmation will affect your claim or equity interest, as the variations on this general rule are numerous and complex.***

**C. Liquidation Analysis**

To confirm the Plan, the Court must find that all creditors and equity interest holders who do not accept the Plan will receive at least as much under the Plan as such claim and equity interest holders would receive in a chapter 7 liquidation. A liquidation analysis is attached to this Disclosure Statement as Exhibit E.

**D. Feasibility**

The Court must find that confirmation of the Plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the Debtor or any successor to the Debtor, unless such liquidation or reorganization is proposed in the Plan.

1. *Ability to Initially Fund Plan*

The Plan Proponent believes that the Debtor will have enough cash on hand on the effective date of the Plan to pay all the claims and expenses that are entitled to be paid on that date. Tables showing the amount of cash on hand on the effective date of the Plan, and the sources of that cash are attached to this disclosure statement as Exhibit F.

2. *Ability to Make Future Plan Payments and Operate Without Further Reorganization*

The Plan Proponent must also show that it will have enough cash over the life of the Plan to make the required Plan payments.

The Plan Proponent has provided projected financial information. Those projections are listed in Exhibit G.

**The Plan Proponent's financial projections show that the Debtor will have an aggregate annual cash flow, after paying operating expenses and post-confirmation taxes, of \_\_\_\_\_.**  
**The final Plan payment is expected to be paid on \_\_\_\_\_.**

***You Should Consult with Your Accountant or other Financial Advisor If You Have Any Questions Pertaining to These Projections.***

**V. EFFECT OF CONFIRMATION OF PLAN**

**A. DISCHARGE OF DEBTOR**

Discharge. On the effective date of the Plan, the Debtor shall be discharged from any debt that arose before confirmation of the Plan, subject to the occurrence of the effective date, to the extent specified in § 1141(d)(1)(A) of the Code, except that the Debtor shall not be discharged of any debt (i) imposed by the Plan, (ii) of a kind specified in § 1141(d)(6)(A) if a timely complaint was filed in accordance with Rule 4007(c) of the Federal Rules of Bankruptcy Procedure, or (iii) of a kind specified in § 1141(d)(6)(B).

After the effective date of the Plan your claims against the Debtor will be limited to the debts described in clauses (i) through (iii) of the preceding sentence.

**B. Modification of Plan**

The Plan Proponent may modify the Plan at any time before confirmation of the Plan. However, the Court may require a new disclosure statement and/or revoting on the Plan.

The Plan Proponent may also seek to modify the Plan at any time after confirmation only if (1) the Plan has not been substantially consummated *and* (2) the Court authorizes the proposed modifications after notice and a hearing.

**C. Final Decree**

Once the estate has been fully administered, as provided in Rule 3022 of the Federal Rules of Bankruptcy Procedure, the Plan Proponent, or such other party as the Court shall designate in the Plan Confirmation Order, shall file a motion with the Court to obtain a final decree to close the case. Alternatively, the Court may enter such a final decree on its own motion.

**VI. CONCLUSION**

All holders of claims against the Debtor are urged to vote to accept the plan and to evidence such acceptance by returning their ballots so that they will be received by the deadline for voting which is \_\_\_\_\_ at 5:00 p.m. (Houston Time).

Dated: 12/7, 2017.

Deep Operating, LLC, a Texas Limited Liability Company  
Debtor-in-Possession

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Javier Arellano, Chief Executive Officer

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