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Playing Offense and Defense—Insolvency Considerations in a Down Cycle for Oil Field Services Companies

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Selected Oil Perspectives

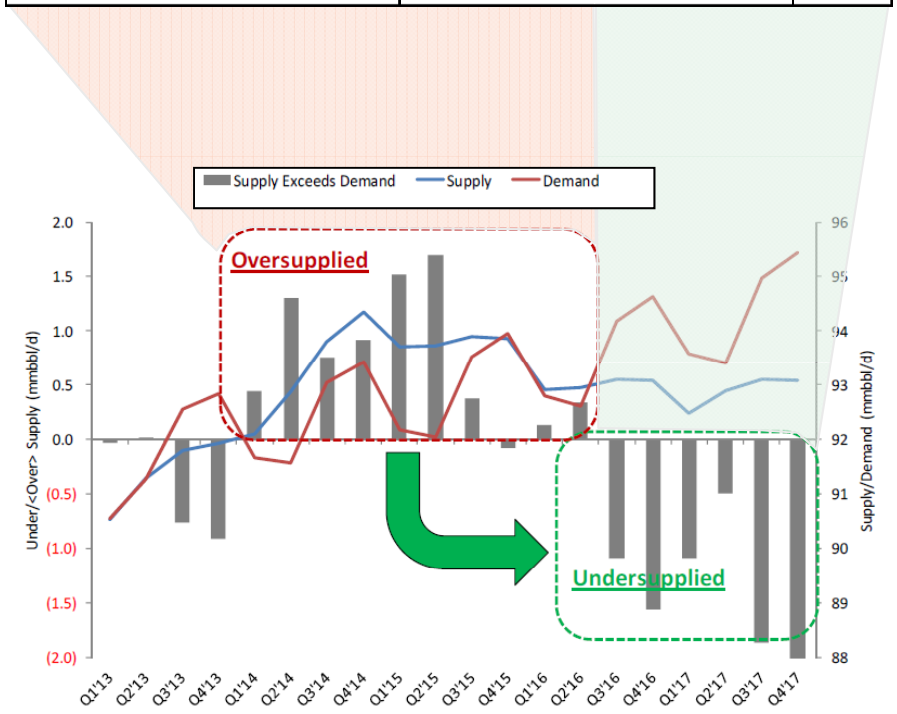
Selected Commentary

- The sharp decline in U.S. rig count should cause a response in near-term production
  - U.S. rig count down 1,235 rigs (RigData as of May 22, 2015)
  - Expect U.S. sequential supply growth to flatten and begin to contract by late 2015
  - Forecasting 2016 year-over-year production decline of ~270 kbpd, which will potentially create an undersupply situation and require a strong U.S. response to rebalance the market
- There has been no net supply growth outside of the U.S. since 2008 even in an elevated commodity environment
- TPH assumes muted global demand growth
  - Through 2017, average global demand growth expected to be ~600 kbpd per year (as compared to ~925 kbpd average demand growth over last 10 years)

Oil Forecast and Supply/Demand Dynamics

TPH WTI Forecast ($/Bbl)

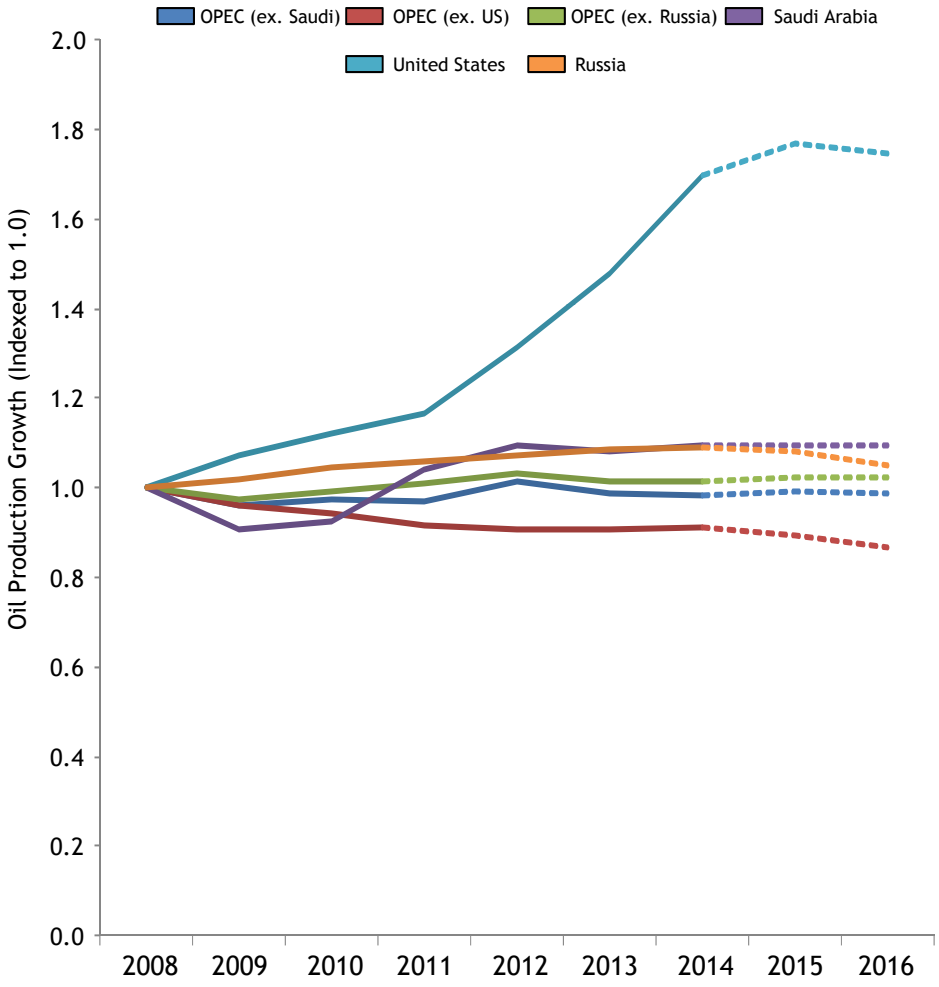
Q1 '15E	Q2 '15E	Q3 '15E	Q4 '15E	Q1 '16E	Q2 '16E	Q3 '16E	Q4 '16E	FY '17E
$50	$50	$60	$65	$75	$80	$80	$85	$90



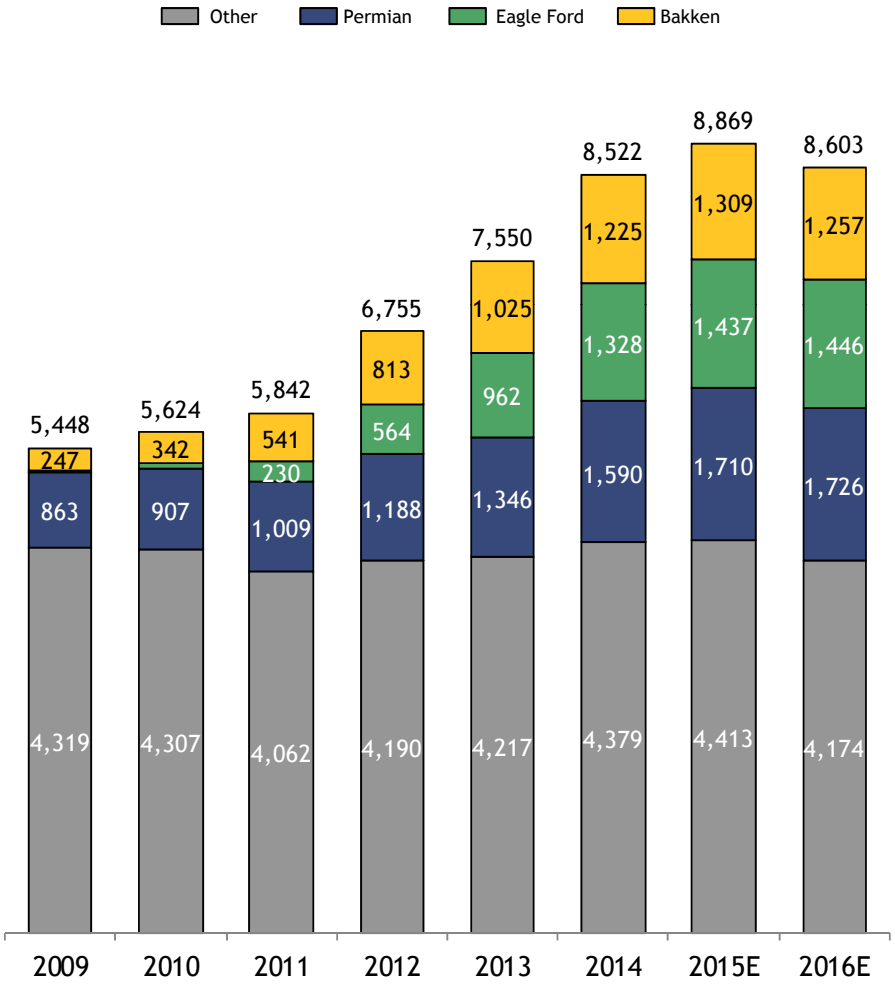
Source: TPH.

Oil Production Overview

U.S. Causing the Problem



U.S. Oil Production by Basin (Mbbl/d)



Source: TPH, EIA.

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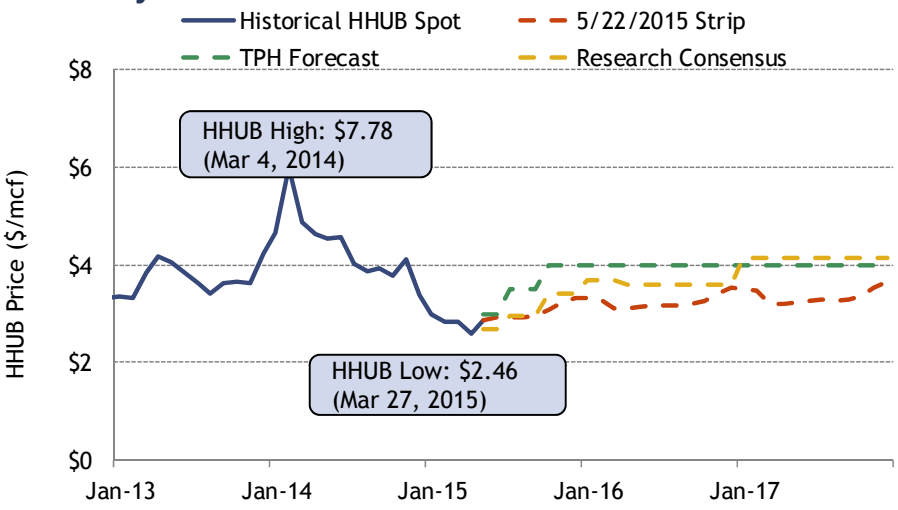
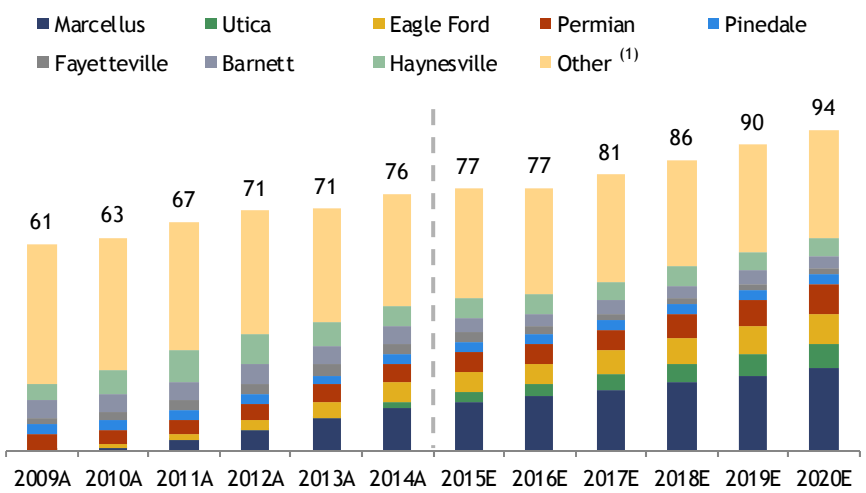
Commentary on Recent Gas Performance

Henry Hub Historical Performance & Forecast



TPHe Natural Gas Supply *(Bcf / d)*

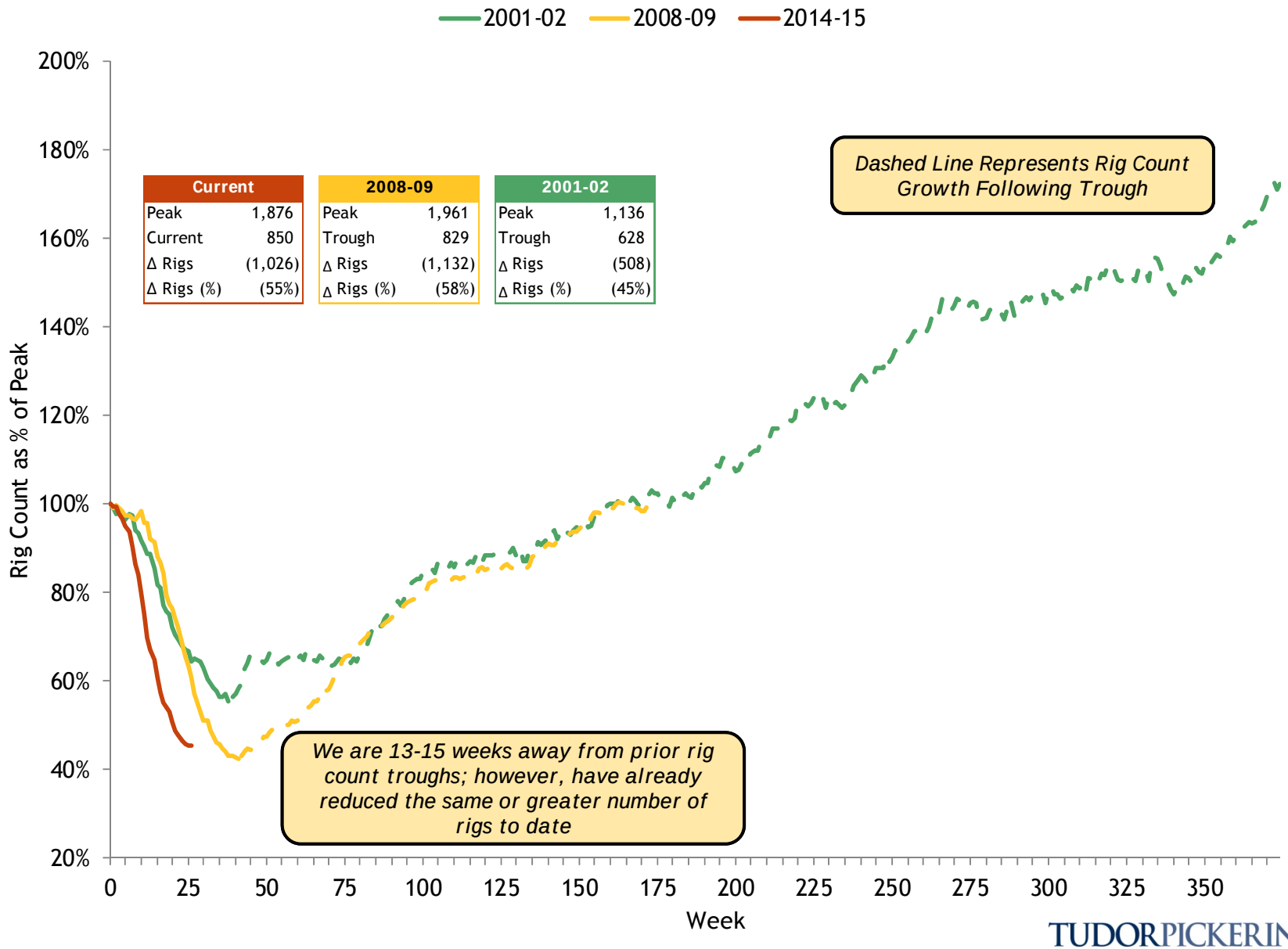


TPH Commentary on Gas

- **Near term (2015)**
  - Gas market balances on price
  - A gas production response to current soft prices (and wide Northeast basis) won't significantly impact fundamentals until 2016
  - A $3.40/mmbtu price is required to balance the market within a year
  - *Ongoing rig count reductions help to tighten '15 gas market*
- **Mid-term (2016)**
  - Associated gas / gas-directed rig count declines significantly slow gas growth (TPHe flat in 2016)
  - *Weak 1H 2015 gas prices, wide Northeast basis and degraded wet gas economics will drive a 2016 supply response*
  - Expecting NYMEX to rebound towards and remain above $4/mcf for a good portion of the year
- **Longer-term (2017+)** –
  - *Supply-demand battle continues and expect additional volatility to both the upside and downside* over the coming years
  - Ultimately, the question remains if the dry gas Utica could back fill the cost curve, replacing legacy dry gas basins entirely and potentially forcing our long term forecast of $4/mcf lower

Source: TPH, Bloomberg and FactSet as of 5/22/2015.
(1) Other includes: SCOOP, Niobrara, Bakken, MS Lime, Granite Wash, Tonkawa, Cleveland, Piceance, Cana Woodford, Fayetteville, FO Gulf and All other U.S. States.

Relative Velocity of Recent U.S. Land Rig Count Declines



Current	
Peak	1,876
Current	850
Δ Rigs	(1,026)
Δ Rigs (%)	(55%)

2008-09	
Peak	1,961
Trough	829
Δ Rigs	(1,132)
Δ Rigs (%)	(58%)

2001-02	
Peak	1,136
Trough	628
Δ Rigs	(508)
Δ Rigs (%)	(45%)

Source: Baker Hughes as of 5/22/2015.

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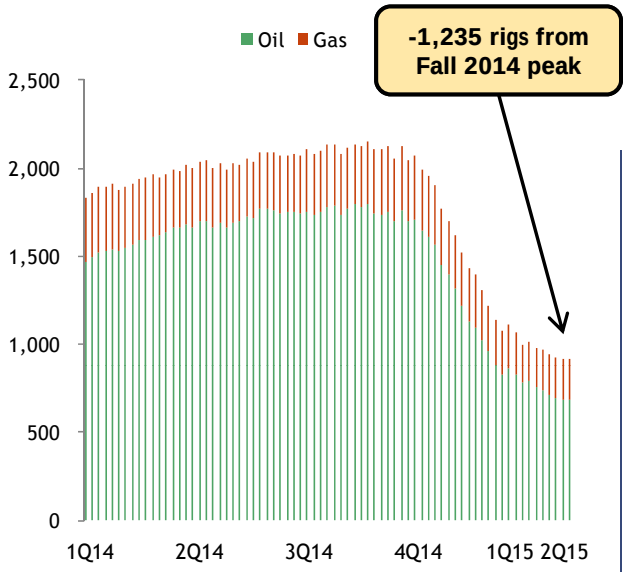
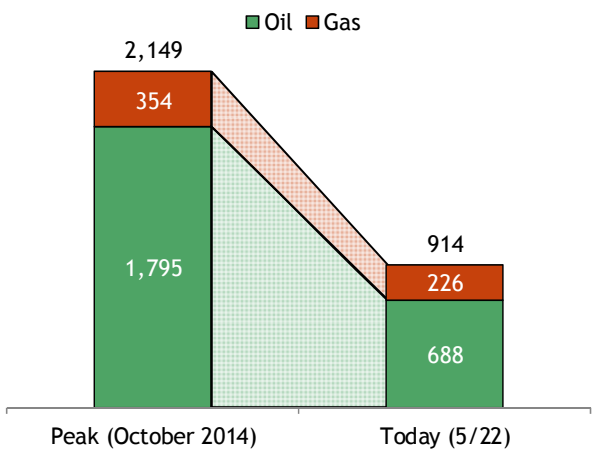
How Are the Various Areas Being Impacted?

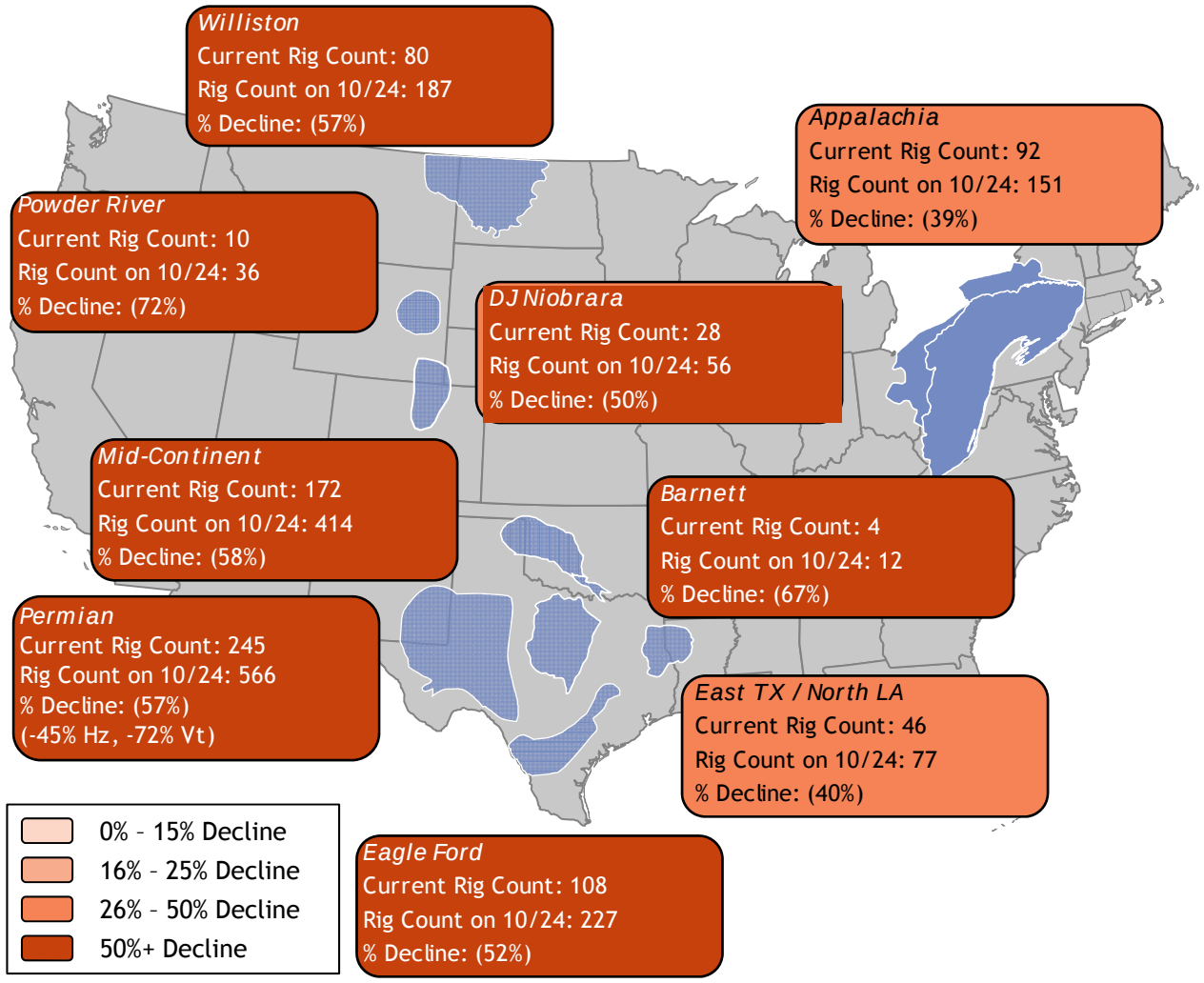
Rig Count Throughout 2014



Peak Count vs. Today



Where Are Rigs Dropping?



Sources: RigData, TPH as of 5/22/2015.

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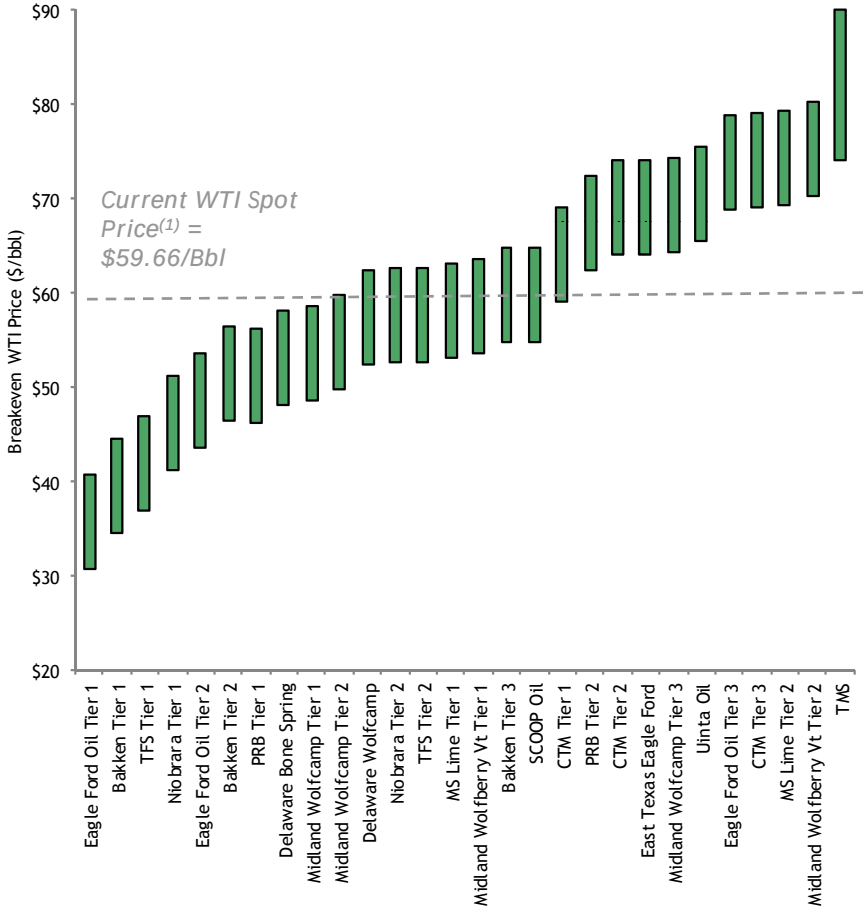
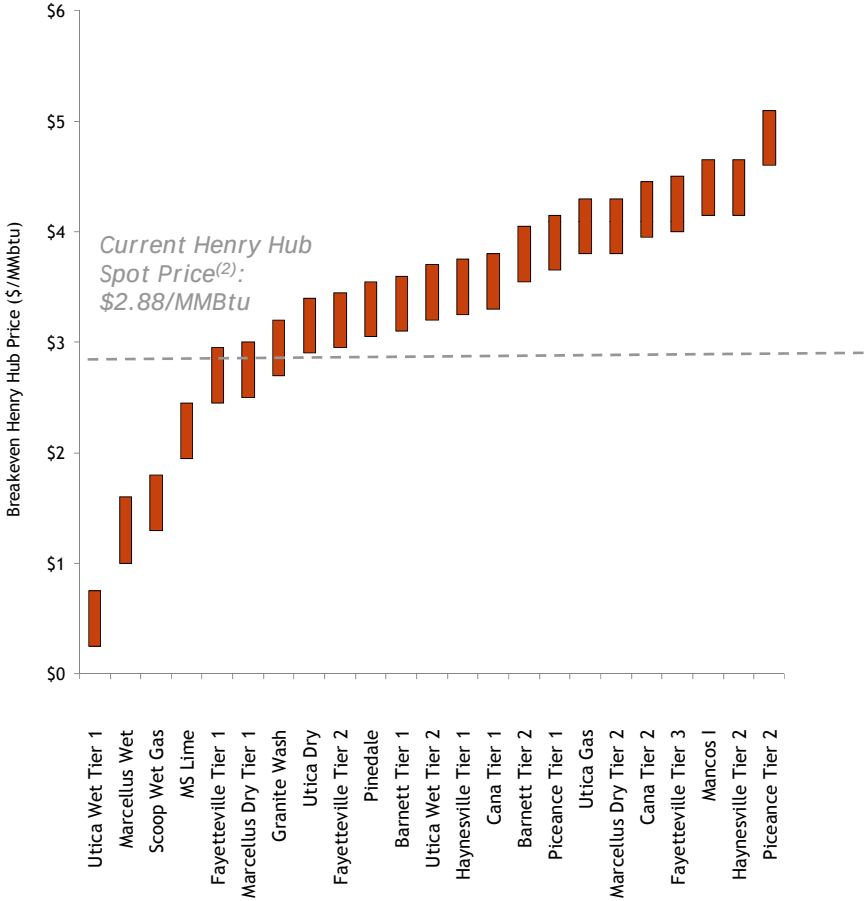
Break-Even Basin Economics

- E&Ps will high grade asset development within core windows of oil resource plays
- Service costs are and will continue to come down in key producing regions such as the Permian and Marcellus; however, these gains are not sustainable long term

Oil Weighted Basins



Gas Weighed Basins



Source: Company Filings & Presentations, RigData, TPH.
Notes: CTM refers to the Cleveland, Tonkawa, Marmaton; economics assume $3.75 /Mcf NYMEX.
(1) Closing WTI spot price as of 5/22/2015.
(2) Closing NYMEX Henry Hub spot price as of 5/22/2015.

Ability to Reduce Service Costs Materially will be Limited in Some OFS Subsectors

($ in millions)

	2007 - 2008 Peak *EBITDA Margins*	2009-2010 Trough *EBITDA Margins*	Previous Margin Degradation	2014 Peak *EBITDA Margins*	Gap from Prior Peak	Illustrative Future Margin Degradation [1]
Majors (NAM Division)						
BHI	35%	9%	(26%)	19%	(16%)	(10%)
HAL	35%	10%	(26%)	25%	(10%)	(16%)
SLB	40%	14%	(26%)	28%	(12%)	(14%)
WFT	39%	9%	(30%)	25%	(13%)	(16%)
Pressure Pumping/Completions						
CJES	33%	7%	(26%)	16%	(17%)	(9%)
RES	34%	10%	(24%)	28%	(6%)	(18%)
TCW-CA	32%	11%	(22%)	15%	(18%)	(4%)
CFW-CA	26%	12%	(14%)	18%	(8%)	(6%)
Land Drillers						
HP [2]	51%	41%	(10%)	42%	(9%)	(1%)
PTEN	43%	24%	(19%)	31%	(12%)	(8%)
Traditional Land Services						
BAS	30%	3%	(27%)	22%	(8%)	(20%)
SPN	42%	23%	(19%)	28%	(14%)	(5%)
KEG	30%	7%	(23%)	13%	(17%)	(6%)
Proppants						
SLCA	NA	NA	NA	30%	NA	NA
HCLP	NA	NA	NA	44%	NA	NA
CRR	35%	28%	(7%)	26%	(9%)	2%

Sources: Company filings and FactSet.
Note: Peaks are calculated as the maximum quarterly EBITDA margin in the years listed; Troughs are calculated as the minimum quarterly EBITDA margin in the years listed. Q2 margins ignored for Canadian pressure pumpers to combat seasonality.
(1) Drop in peak margin to reach 2009-2010 trough.
(2) Includes U.S. division only.

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OFS Debt Analysis

Credit Yields Across the Industry

Land Drilling

Issuer	Market Price	Market YTW
Parker Drilling Company	$85	11.3%
Parker Drilling Company	81	10.6%
Pioneer Energy Services	74	11.6%
Precision Drilling Corporation	101	6.2%
Precision Drilling Corporation	100	6.7%
Precision Drilling Corporation	99	6.7%
Precision Drilling Corporation	86	NA
Sidewinder Drilling	62	24.1%
Unit Corporation	98	7.1%

Compression

Issuer	Market Price	Market YTW
Compressco	$94	8.4%
Exterran Holdings, Inc.	104	6.1%
Exterran Holdings, Inc.	98	6.5%
Exterran Partners, L.P.	87	8.3%

Pressure Pumping / Completion

Issuer	Market Price	Market YTW
Calfrac	$94	9.0%
FTS International	83	9.8%
Sanjel Corp	66	20.3%
Seventy Seven Energy	84	11.2%
Seventy Seven Energy	56	17.2%

Offshore Drillers

Issuer	Market Price	Market YTW
Atwood Oceanics	$98	7.1%
Hercules Offshore	35	50.1%
Hercules Offshore	34	32.8%
Hercules Offshore	35	35.7%
Hercules Offshore	33	30.5%
Ocean Rig Inc.	89	12.2%
Ocean Rig Inc.	74	16.6%
Pacific Drilling	100	8.6%
Pacific Drilling	92	11.0%
Pacific Drilling	84	9.5%
Paragon Offshore	42	24.2%
Paragon Offshore	42	22.3%
Vantage	72	16.7%
Vantage	70	13.4%

Land Services

Issuer	Market Price	Market YTW
Basic Energy Services	$86	12.6%
Basic Energy Services	81	11.6%
Key Energy Services	69	14.9%
Forbes Energy Services	81	15.5%
IronGate Energy Services	63	28.9%
Light Tower Rentals	84	13.4%
Nuverra Environmental Solutions	79	19.6%

Offshore Transport

Issuer	Market Price	Market YTW
CHC Helicopter	$87	12.8%
Bristow Group	100	6.3%
Bristow Group	100	3.0%
GulfMark Offshore	81	10.3%
PHI, Inc.	97	6.3%

Manufacturing

Issuer	Market Price	Market YTW
Forum Energy	$98	6.7%
ShawCor	100	3.0%
ShawCor	100	3.7%
ShawCor	99	4.0%
ShawCor	96	4.5%

Subsea

Issuer	Market Price	Market YTW
Cameron	$99	1.5%
Cameron	99	1.8%
Cameron	111	2.6%
Cameron	106	3.4%
Cameron	99	3.7%
Cameron	101	3.9%
Cameron	98	3.9%
Cameron	117	5.7%
Cameron	107	5.5%
Cameron	97	5.3%
FMC	100	2.1%
FMC	97	3.9%
Helix	103	3.0%
Oceaneering	102	4.4%

Source: FactSet and Bloomberg as of 5/22/2015.

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Selected Public Company Trading Statistics

($ in millions)

A	B	C	D	E	F	G	H	I	J	K
	% of 52 Week	EV/EBITDA			EBITDA Margin			Revenue Growth	Net Debt/EBITDA	
Company	**High**	**2014A**	**2015E**	**2016E**	**2014A**	**2015E**	**2016E**	**2014A-2015E**	**2014A**	**2015E**
Services										
Basic Energy Services	29.5%	3.9x	15.3x	9.2x	21%	9%	13%	(38%)	2.6x	10.3x
Key Energy Services	27.1%	9.5	15.3	8.7	8	7	12	(29)	6.3	10.0
Oil States International	65.2%	6.5	12.9	11.8	24	18	19	(32)	1.2	2.4
Superior Energy Services	63.4%	4.0	7.9	6.3	26	19	22	(28)	1.0	2.0
TETRA Technologies	55.0%	16.3	8.9	7.6	10	20	21	(3)	8.1	4.4
Median	**55.0%**	**6.5x**	**12.9x**	**8.7x**	**21%**	**18%**	**19%**	**(29%)**	**2.6x**	**4.4x**
Mean	**48.0%**	**8.1**	**12.0**	**8.7**	**18**	**14**	**17**	**(26)**	**3.8**	**5.8**
Subsea Focused										
Cameron International	70.1%	7.2x	8.9x	9.8x	16%	16%	15%	(17%)	0.7x	0.8x
Dril-Quip	69.6%	8.7	9.5	11.5	33	31	28	(2)	NM	NM
FMC Technologies	67.2%	8.1	9.8	10.5	16	16	16	(13)	0.5	0.6
Oceaneering International	67.2%	6.9	8.7	8.6	23	21	22	(13)	0.8	1.0
Median	**68.4%**	**7.7x**	**9.2x**	**10.1x**	**20%**	**19%**	**19%**	**(13%)**	**0.7x**	**0.8x**
Mean	**68.5%**	**7.7**	**9.2**	**10.1**	**22**	**21**	**20**	**(11)**	**0.6**	**0.8**
Land Drillers										
Ensign Energy Services	58.0%	4.1x	7.8x	6.5x	24%	20%	21%	(38%)	1.2x	2.3x
Helmerich & Payne	63.3%	5.2	7.2	10.0	42	37	30	(18)	NM	NM
Independence Contract Drilling	61.3%	-13.9	10.4	7.2	(22)	22	25	30	NM	1.2
Nabors Industries	52.0%	4.6	7.0	7.0	26	31	33	(45)	1.6	2.5
Patterson-UTI Energy	55.7%	4.2	7.8	7.3	31	27	27	(38)	1.0	1.8
Precision Drilling	48.5%	4.4	8.2	6.5	34	29	31	(37)	1.5	2.8
Median	**56.8%**	**4.3x**	**7.8x**	**7.1x**	**28%**	**28%**	**29%**	**(37%)**	**1.4x**	**2.3x**
Mean	**56.5%**	**1.4**	**8.0**	**7.4**	**22**	**28**	**28**	**(24)**	**1.3**	**2.1**
Offshore Drillers										
Atwood Oceanics	62.3%	6.8x	4.9x	6.3x	47%	55%	48%	18%	2.8x	2.0x
Diamond Offshore	62.9%	5.8	7.0	9.1	40	38	34	(13)	1.8	2.2
Ensco PLC	44.9%	4.4	5.3	6.4	52	47	43	(8)	1.9	2.3
Noble Corporation plc	58.4%	6.5	6.4	7.5	48	51	48	(4)	3.1	3.0
Rowan Cos. Plc Class A	71.5%	8.0	6.3	6.3	39	43	42	16	3.9	3.0
Transocean Ltd.	43.7%	3.9	5.6	10.0	42	39	28	(25)	1.9	2.7
Median	**60.3%**	**6.1x**	**5.9x**	**7.0x**	**44%**	**45%**	**42%**	**(6%)**	**2.3x**	**2.5x**
Mean	**57.3%**	**5.9**	**5.9**	**7.6**	**45**	**46**	**40**	**(3)**	**2.6**	**2.5**

Source: Company filings, FactSet as of 5/22/2015.

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($ in millions)

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Company	High	2014A	2015E	2016E	2014A	2015E	2016E	2014A-2015E	2014A	2015E
Majors										
Baker Hughes Inc	86.6%	6.5x	14.5x	11.2x	20%	14%	17%	(35%)	0.7x	1.4x
Halliburton Co.	61.8%	11.4	18.5	16.3	22	18	19	(25)	2.5	4.0
Schlumberger Ltd.	77.5%	9.2	12.4	11.9	28	27	26	(22)	0.4	0.6
Weatherford Intl	58.8%	7.4	10.6	8.7	17	17	20	(32)	2.8	4.0
Median	**69.6%**	**8.3x**	**13.5x**	**11.6x**	**21%**	**18%**	**19%**	**(28%)**	**1.6x**	**2.7x**
Mean	**71.2%**	**8.6**	**14.0**	**12.0**	**22**	**19**	**20**	**(28)**	**1.6**	**2.5**
Pressure Pumping / Completion										
Calfrac Well Services	33.5%	4.0x	21.1x	6.4x	15%	4%	11%	(33%)	1.9x	10.2x
C&J Energy Services	45.3%	12.0	25.9	9.7	16	5	11	37	4.3	9.3
RPC Inc.	58.7%	5.3	15.7	9.4	28	16	23	(43)	0.2	0.6
Trican Well Service	19.1%	4.5	NA	8.9	10	(0)	7	(47)	2.4	NM
Median	**39.4%**	**4.9x**	**21.1x**	**9.1x**	**15%**	**5%**	**11%**	**(38%)**	**2.2x**	**9.3x**
Mean	**39.2%**	**6.4**	**20.9**	**8.6**	**17**	**6**	**13**	**(22)**	**2.2**	**6.7**
Manufacturing										
Forum Energy Technologies	57.8%	7.5x	11.7x	10.6x	18%	16%	17%	(28%)	1.2x	1.9x
Flotek Industries	37.8%	7.4	50.0	15.7	22	5	13	(31)	0.5	3.2
National-Oilwell Varco	58.6%	4.5	8.0	8.8	22	16	16	(25)	0.3	0.5
Schoeller-Bleckmann	49.9%	5.6	9.8	8.1	30	24	28	(28)	0.3	0.6
Tesco Corporation	54.7%	4.6	11.5	8.5	17	12	14	(41)	NM	NM
Median	**54.7%**	**5.6x**	**11.5x**	**8.8x**	**22%**	**16%**	**16%**	**(28%)**	**0.4x**	**1.2x**
Mean	**51.8%**	**5.9**	**18.2**	**10.3**	**22**	**14**	**17**	**(31)**	**0.6**	**1.5**
Proppant Companies										
Carbo Ceramics	25.4%	5.8x	NA	22.3x	24%	(6%)	11%	(55%)	NM	1.2x
Emerge Energy Services	27.5%	9.7	14.3	10.8	11	10	12	(27)	1.9	2.7
Fairmount Santrol	50.7%	6.9	11.2	9.3	28	22	23	(22)	3.2	5.3
Hi-Crush	41.5%	5.4	7.4	5.2	39	27	32	4	NM	NM
US Silica Holdings	43.3%	8.5	13.1	9.7	25	21	24	(22)	0.8	1.2
Median	**41.5%**	**6.9x**	**12.2x**	**9.7x**	**25%**	**21%**	**23%**	**(22%)**	**1.9x**	**2.0x**
Mean	**37.7%**	**7.3**	**11.5**	**11.5**	**25**	**15**	**20**	**(24)**	**1.9**	**2.6**

Source: Company filings, FactSet as of 5/22/2015.

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Playing Offense

Protecting Yourself Prepetition: Counterparty Distress (KYC) and Ensuring Payment

- Contract Negotiations
  - Suspension of Work Provisions
  - Delay payments, interest, Day-Rate or Equivalent Accruing Charges, Costs of fees and Expenses for Enforcement
  - Termination of Work
  - Escrow, Prepayment & Guarantees, LOCs
  - Access to Site / Demobilization and Equipment Removal
- Operating Under the Contracts – Pre-Petition or Pre-bankruptcy
  - Prepayment
  - Suspension of Work
  - Liens
  - Trapping Letters
  - Avoid Preference Exposure

Securing Payment: Remedies and Strategies

- Avoid Asleep at the Wheel Syndrome
  - Accumulation of Receivables indicative of problem
  - Increase in float of Past-Due invoices
  - Active Monitoring to Deploy strategies and exercise leverage
  - Manage outstanding receivables proactively
- Prepayment or Deposit: Payment for Services Before Incurred
  - Advance payment for services not voidable as a preference
  - Manage exposure and limit credit extension (even for 30 day invoices)
  - Avoids forced lending on backs of creditors

Securing Payment: Remedies and Strategies (cont.)

- Oilfield Liens
  - Filing/Perfecting Liens
  - Trapping Letters to First Party Purchasers
- State Law Reclamation Rights
  - Right to reclaim goods delivered within fixed period as a result of repayment
  - Requires strict adherence to deadlines for reclamation
  - Bankruptcy Code honors and preserves such rights, even for goods delivered prepetition

Protecting Yourself Post-Petition: Counterparty Distress

- Reclamation Remedies
  - Entitled to administrative claim &/or liens in protection of amounts for goods in inventory delivered within twenty days pre-filing
- Oilfield Lien Rights & Perfecting Claims under State Law
  - Not precluded by Automatic Stay under Section 362
  - Cash Collateral & DIP Loan Protections
  - Adequate Protection Remedies
    - Replacement Liens or additional collateral
- JOAs
  - Automatic Stay does not preclude exercise of rights or liens against non-bankruptcy interest holders
  - Trapping JIB payments

Playing Defense

Director and Officer Duties – Insolvency Considerations

- May 4, 2015, Delaware Court of Chancery in *Quadrant Structured Products Co., Ltd. v. Vertim* (Vice Chancellor Laster)
  - Summarized directors' fiduciary duties to creditors – affirmed N. Am. Catholic Educ. Programming Fraud, Inc. v Gheewalla (Del. 2007)

PRE-*GHEEWALLA*	POST-*GHEEWALLA*
Directors owe fiduciary duties to creditors once a corporation "enter[s] the vicinity of insolvency."	Directors owe fiduciary duties to creditors only once a corporation actually is insolvent.
Creditors may bring direct or derivative claims to enforce fiduciary duties.	Creditors may only bring derivative claims to enforce fiduciary duties.
Directors have an "obligation to manage the corporation conservatively as a trust fund for the creditors' benefit."	Directors do not owe any particular duties to creditors; rather, their fiduciary duty runs "to the corporation for the benefit of all of its residual claimants," including creditors.
Director decisions are subject to entire fairness review because of the "inherent conflict" arising when fiduciary duties are owed both to creditors and stockholders.	Directors may, in an exercise of their business judgment, "favor certain non-insider creditors over others of similar priority." In addition, directors' ownership of common stock alone "does not give rise to a conflict of interest."
Directors could be liable for continuing to operate an insolvent entity and incurring greater losses for creditors under a theory known as "deepening insolvency."	The theory of "deepening insolvency" is rejected.

Director and Officer Duties – Insolvency Considerations (con't)

- Held creditors have standing to sue derivatively if corporation is insolvent at the commencement of the suit – even if later corporation becomes solvent
- Discussed "reasonable market value" of the assets to include the "prospect value" of business opportunities (not just balance sheet test).
- Affirmed cash-flow (equitable) test of insolvency – able to meet debts as they come due

Director and Officer Duties – Insolvency Considerations (con't)

II. *Quadrant* – makes clear that creditors can now bring derivative claims only for "acts of self-dealing and other examples of self-interested or bad faith conduct" as residual beneficiaries if a corporation is insolvent.

Per *In re Cornerstone Therapeutics Inc. Stockholder Litigation* (Del. May 14, 2015), this would mean that

- plaintiffs seeking only monetary damages must plead non-exculpated claims against directors protected under a charter provision authorized by DCL § 102(b)(7).
- must show that each named director:
  - "harbored self-interest adverse to the stockholder's interest,"
  - sought to "advance the self-interest of an interested party from whom they could not be presumed to act independently" or
  - "acted in bad faith".

Director and Officer Duties – Insolvency Considerations (con't)

III. Directors should now consider whether the corporation <u>might</u> be insolvent (balance sheet or equity) when making decisions.

Derivative actions can be expensive and difficult to dismiss.

Business Considerations if you are the Distressed Contract Party

- Anticipate Distress Will Impact Payment Demands
  - Expect prepayment demands from subcontractors in managing liquidity
  - Attention to claims (contractual & tort claims) for misuse of payments due subcontractors
  - Termination of contract risk
- Manage service contracts as critical revenue
- Insurance critical for services
  - Aware of LOC Security if Provided
- Advance discussion with Lenders in managing covenants and liquidity
- Monetization of Assets /Fraudulent conveyance concerns
- Business Judgment Considerations and body of creditors to be protected – Avoid Loyalty Conflicts

Oilfield Lien Rights

- Inchoate
- Subject to Applicable State Law
  - Oilfield Lien Statutes in Traditional oil producing states
  - "New" oil producing states – M&M Lien Law possibility
- Offshore: OCSLA & Relevant State law
  - Limitations and Enforceability
- Relation-Back Priority
- Burdens Entire Oil Producing Property (& non-op parties' interests)
- Pressure on Senior and Junior secured parties & counterparty with exercise of remedies
- Trapping Letters on First party Purchasers and Traditional Response

NPIs & ORRIs: Risk of Acceptance?

- Industry Tool for Payment provides risk to Service Companies
- Bankruptcy Code Section 541 Exception From Estate Property Arguably Excludes Service Companies
- Economic Recharacterization Claim Stronger Against Vendors
- Expect Financing Treatment and Obtain Subordination Agreements and Perfect Accordingly – Subject to Preference Avoidance if not managed well
- Golden Rule in Bankruptcies: Leverage to the party holding cash

Speakers' Bios

David Cunningham

Managing Director, Co-Head of OFS IB
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David Cunningham is a Managing Director in Investment Banking covering the oilfield services sector. Cunningham was previously a managing director with the Global Energy Group at Credit Suisse where he has led and executed various merger, acquisition, restructuring, equity, debt (high-yield and investment grade) and asset valuation transactions. Prior to that, Cunningham was at Eppler, Guerin & Turner, Inc., a boutique investment bank in Dallas, Texas, where his primary focus included the oilfield services and upstream sectors. Cunningham holds a BA in Finance from Texas Christian University and an MBA from the University of Chicago Graduate School of Business.

Speakers' Bios (con't)

Robert F. "Bob" Gray, Jr.

Bob Gray is a partner in the Houston office and is co-leader of the firm's Corporate & Securities practice. Bob has advised boards of directors, as well as audit and special committees, of public companies in many industries. Bob has represented a variety of public and private companies, underwriters, and equity investors/venture funds in private placements, public offerings and mergers and acquisitions. His extensive industry experience is a significant advantage for clients operating in the energy and technology arenas.

Bob received his LLM from New York University and his JD from the University of San Diego School of Law. He attended the University of Michigan for both his MBA and BBA.

Charles S. Kelley

Charles Kelley focuses on civil litigation, restructuring, bankruptcy and insolvency. He represents major corporations, oil companies, national construction engineering firms, real estate investment companies, banks, accounting firms, and other business entities in federal and state court litigation involving federal and state statutes, common law claims, professional malpractice claims, and other commercial litigation.

Charles's experience has included a jury trial in federal court, and state court bench trials. Prior to law school, he was employed by Amoco Oil Company as a mechanical engineer and held positions as a project engineer, inspection engineer, and unit maintenance engineer in Amoco's largest and most complex refinery.

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Playing Offense and Defense—Insolvency Considerations in a Down Cycle for Oil Field Services Companies

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