IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	
VANGUARD NATURAL RESOURCES, LLC *et al.*,[1]	§	CASE NO. 17-30560 (MI)
	§	
	§	CHAPTER 11
Debtor.	§	

THE AD HOC EQUITY COMMITTEE'S (A) PRELIMINARY OBJECTION TO THE DEBTORS' DISCLOSURE STATEMENT, AND (B) REQUEST FOR VALUATION HEARING
[Relates to Docket No. 216]

The Ad Hoc Equity Committee (the "Equity Committee"), compromising certain unaffiliated holders of Vanguard Natural Resources, LLC's ("VNR") preferred and common units, by and through its undersigned counsel, hereby files this Preliminary Objection[2] to the Debtors' *Disclosure Statement Relating to the Joint Plan of Reorganization of Vanguard Natural Resources, LLC, et al, Pursuant to Chapter 11 of the Bankruptcy Code* ("Disclosure Statement") [Docket No. 216] and further requests this Court conduct an evidentiary hearing to establish the valuation of the Debtors' business (a "Valuation Hearing") in advance of the hearing to approve the Disclosure Statement, and in support thereof, respectfully submits as follows:

1. The Equity Committee was formed to ensure that the Debtors' preferred and common unitholders (the "Equity Holders") have a voice in these proceedings. From the inception of these cases, the Debtors' management ("Management") has represented that the value of Debtors is so low that the Equity Holders must not only lose their investments, but also

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Vanguard Natural Resources, LLC (1161); Eagle Rock Acquisition Partnership, L.P. (6706); Eagle Rock Acquisition Partnership II, L.P. (0903); Eagle Rock Acquisition Co., Inc. (4564); Eagle Rock Energy Acquisition Co. II, Inc. (3364); Eagle Rock Upstream Development Company, Inc. (0113); Eagle Rock Upstream Development Company II, Inc. (7453); Encore Clear Fork Pipeline LLC (2032); Escambia Asset Co. LLC (3869); Escambia Operating Co. LLC (2000); Vanguard Natural Gas, LLC (1004); Vanguard Operating, LLC (9331); VNR Finance Corp. (1494); and VNR Holdings, LLC (6371). The location of the Debtors' service address is: 5847 San Felipe, Suite 3000, Houston, Texas 77057.

[2] The Debtors have informed counsel for the Equity Committee that an amended Disclosure Statement is to be filed soon. The Equity Committee will supplement this response following the filing of the amendment.

must be made to bear the full taxation brunt of cancellation of debt income ("CODI") – the impact of which will be in the tens of millions of dollars.

2. Simultaneously with its formation, the Equity Committee retained Huron Consulting Services LLC ("Huron") to conduct a formal valuation of the Debtors. The Equity Committee viewed a formal valuation to be critical, particularly in light of Management's conflicting representations as to the enterprise value of the Debtors in the months immediately preceding the bankruptcy filing on February 1, 2017 (the "Petition Date").

3. Huron has concluded its valuation, the results of which reveal that the valuation premise set forth in the Disclosure Statement and imbedded in the Debtors' *Joint Plan of Reorganization of Vanguard Natural Resources, LLC, et al., Pursuant to Chapter 11 of the Bankruptcy Code* (the "Plan") [Docket No. 215], borne from a pre-bankruptcy negotiated Restructuring Support Agreement ("RSA"), is hundreds of millions of dollars short.

4. Huron believes that the Debtors' reorganization value[3] is in the range of $2.1 billion to $2.6 billion with a midpoint of $2.35 billion (the "Huron Valuation").[4] By comparison, the Disclosure Statement states that the Plan is premised on an enterprise value of the Debtors of only $1.625 billion. With allegedly approximately $1.8 billion of debt, this $725 million swing between Management's purported valuation versus the midpoint of the Huron Valuation

[3] "Reorganization value" is defined as "the value attributed to the reconstituted entity, as well as the expected net realizable value of those assets that will be disposed before reconstitution occurs. Therefore, this value is viewed as the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring." Association of Insolvency & Restructuring Advisors Standards for Distressed Business Valuation, https://www.aira.org/pdf/standards/AIRA_Standards_2014.pdf.

[4] Huron's analysis contemplates facts and conditions known and existing as of April 18, 2017. Events and conditions after this date, including updated financial projections or changes to the reserve report, as well as other factors, could have substantial effect upon the reorganization value. Subsequent developments may affect Huron's conclusions; Huron does not have any obligation to update, revise, or reaffirm its estimate. Huron assumed the financial projections, reserve and resource reports and other information provided by the Debtors were prepared in good faith, on a reasonable basis and are based upon fully disclosed assumptions. Huron has relied upon the accuracy, completeness, and fairness of information furnished by the Debtors. Huron did not attempt to independently audit or verify such information and does not offer an opinion as to the attainability of the Debtors' projections.

mandates immediate Court intervention to ensure that the Equity Holders are treated fairly. Failure to do so has dire consequences to the Equity Holders.

5. To understand how Management reached their conclusions on the Debtors' value, the Equity Committee, along with Huron, has been engaged in both informal and formal discovery with the Debtors.[5] The Disclosure Statement, as originally filed, failed to include any information supporting the representation therein that the Debtors' "Plan Value [is] $1.625 billion." (See footnote 3 of the Disclosure Statement). The Disclosure Statement referenced an exhibit that was a valuation analysis, but all that was stated was that it was "[TO COME]." (See Ex. G to Disclosure Statement). The Equity Committee has since learned how accurate that statement was, because Management never conducted nor otherwise sought to obtain a formal valuation of the Debtors prior to entering into the RSA or filing the Plan and Disclosure Statement,[6] nor was a marketing process of the Debtors' assets undertaken.[7] The Huron Valuation establishes that equity is substantially undervalued by the Debtors' Management, should expect a significant recovery (not the empty promise of warrants) and should not bear the CODI tax liability.

[5] Huron has evaluated materials provided by the Debtors in both the Debtors' virtual data room and from information that is publicly available about both the Debtors and the Debtors' peers in the energy industry. Huron's due diligence procedures included reviewing publicly available information as well as information received directly from the Debtors, a portion of which is subject to a Confidentiality and Non-Disclosure Agreement. The information included reviews of Debtors' financial projections, reserve and resource reports, management reports, Securities & Exchange Commission disclosures by the Debtors, and Debtors' bankruptcy court filings as well as information from other third parties including Bloomberg, S&P Capital IQ, CME Group, United States Energy Information Administration, The World Bank, Organization of the Petroleum Exporting Countries, and the Society of Petroleum Evaluation Engineers.

[6] The Debtors are presumably reverse engineering a valuation that the Equity Committee suspects will be included in the amended Disclosure Statement and will coincidentally align with the construct of the RSA. How Management will reconcile such low valuation of the Debtors against their own "Management Presentations" filed with the SEC on the eve of the bankruptcy remains to be seen.

[7] The Equity Committee is disturbed by what appears to be a failure by Management to test the value of the Debtors' business or assets through a legitimate marketing process, yet Management negotiated an RSA that basically wipes out the Equity Holders, provides 10% of new equity to Management, and provides third-party releases to both Management and the counter-parties to the RSA. The Equity Committee is considering seeking the appointment of a Chapter 11 trustee, who is not conflicted and who can at least conduct a legitimate marketing process.

6. It is premature to move forward with what Management has proposed in the way of the RSA-constructed Plan and Disclosure Statement. The Debtors have sufficient cash,[8] and the only timing constraint imposed on the Debtors was manufactured by Management and certain bondholders in the arbitrary deadlines imbedded in the RSA. The cost of the proposed Plan to the Equity Holders is too high not to take a pause and ensure that the Debtors are being reorganized in a thoughtful manner.

7. The dramatic difference in the valuation of the Debtors is a gating issue. The Huron Valuation effectively renders the Debtors' Plan unconfirmable on its face. Proceeding with a Disclosure Statement hearing, much less a solicitation process, would be a waste of resources.

8. In the Huron Valuation, Huron used the following market-standard valuation methodologies in its valuation analysis: (i) net asset value ("NAV"); (ii) discounted cash flow ("DCF"); (iii) guideline company (or market multiples); and (iv) precedent transactions. Under the NAV method, the major focus is on future cash flows generated by the existing oil and gas reserves as described in the Debtors' reserve report, discounted to present value. A risk adjustment factor is then applied to the classes of reserves. The analysis also takes into account other items such as general and administrative expenses, asset retirement obligations, cost savings, and other items. In comparison, the DCF analysis focuses on the Debtors' January 2017 Management Presentation business plan (*i.e.*, the Debtors' projected unlevered future free cash flow for 2017 to 2020 and the calculation of a terminal value (*e.g.*, EBITDA multiple) discounted to present value).

9. Under the guideline company or market multiples valuation method, the focus is on the Debtors' peers. In other words, the Debtors' reorganization value is estimated in relation

[8] Notably, since the Petition Date, the Debtors are continually postponing the hearing on the Motion to approve their DIP financing facility because they have not needed the funding.

to its peers using enterprise value multiples for key financial and operating metrics of relevant companies. Unlike the NAV method, the guideline company approach provides insight into the market's perceptions on the value of income-generating characteristics of both tangible and intangible assets of a studied company as a going-concern value as well as the market's perceptions of incremental value, i.e., future development opportunities. Finally, the precedent transactions methodology evaluates what has actually occurred in the market with past merger and acquisition transactions.

10. Without the Debtors explanation of the valuation methodologies used and the inputs for those valuation methods, including what discount rates were used, what prices were used, and what other factors were taken into account, it is impossible for a hypothetical investor to make an informed decision about how the Debtors arrived at the $1.625 billion figure. In addition, a hypothetical investor would want to know: (i) what specifically changed between the Debtors' January 2017 Management Presentation and the execution of the RSA; and (ii) how the Debtors are going to explain the differences between the Debtors' value and the substantially higher Huron Valuation.

11. What also cannot be reconciled is Management's justification for negotiating the Management Incentive Plan ("MIP"), which gives them 10% of the equity post-confirmation. The Debtors have not disclosed how and why the MIP was negotiated and why this benefit to Management is not discriminatory.

12. Further mystery lies in Management's willingness to allow the Debtors to give third party releases, and to compel the Equity Holders to concede to overly broad and impermissible non-debtor third party releases (unless the Equity Holders proactively "opt out" of such releases). In a perfunctory statement, the Disclosure Statement provides that such "Released Parties" and "Exculpated Parties" have made "substantial and valuable contributions,"

yet no information is disclosed about what those substantial and valuable contributions have been and how they are permissible under Fifth Circuit law.

II.
CONCLUSION

13. Based on the Huron Valuation – the only formal valuation of the Debtors that has been undertaken – Debtors' Plan is not confirmable and the Disclosure Statement cannot be approved. *See, e.g., In re Filex, Inc.*, 116 B.R. 37, 41 (Bankr. S.D.N.Y. 1990) ("this court will not approve a disclosure statement for an admittedly unconfirmable plan"); *In re Quigley Co.,* 377 B.R. 110, 115-116 (Bankr. S.D.N.Y. 2007) ("A disclosure statement must contain 'adequate information,' 11 U.S.C. § 1125(a) and (b), describing a confirmable plan. If the plan is patently unconfirmable on its face, the application to approve the disclosure statement must be denied, as solicitation of the vote would be futile."). In light of the gating valuation issues, as well as the other fatal flaws in the Plan and Disclosure Statement, there is sufficient cause to hit the "pause" button and conduct a Valuation Hearing to ensure that the Debtors' reorganization is undertaken to not only maximize value, but to ensure that all alternatives are considered before saddling the Equity Holders with a significant tax burden.

III.
RESERVATION OF RIGHTS

14. The Equity Committee reserves its rights to raise additional objections to the Disclosure Statement. The Equity Committee reserves its rights to raise objections to the Solicitation Motion.

WHEREFORE, the Equity Committee requests this Court to enter an Order (a) setting a Valuation Hearing in these cases; (b) denying approval of the Disclosure Statement; and (c) awarding the Equity Committee such other and further relief that this Court deems just and proper.

Dated: April 21, 2017
Houston, Texas

Respectfully submitted,

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/s/ Sharon M. Beausoleil

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ATTORNEYS FOR AD HOC EQUITY COMMITTEE

CERTIFICATE OF SERVICE

I do hereby certify that on April 21, 2017 a true and correct copy of the foregoing pleading was served via CM/ECF to all parties authorized to receive electronic notice in these cases.

/s/ Sharon M. Beausoleil
Sharon M. Beausoleil