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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	)	Case No. 09-31797-bjh-11
CRUSADER ENERGY GROUP INC. *et al.*	)	Chapter 11
Debtors.	)	(Jointly Administered)

MOTION FOR AN ORDER APPOINTING AN OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS

TO THE HONORABLE BARBARA J. HOUSER, CHIEF UNITED STATES BANKRUPTCY JUDGE:

The Ad Hoc Committee of Equity Security Holders (the "Ad Hoc Committee")[1] whose members are holders or affiliated with holders of common stock issued by Crusader Energy

[1] The Ad Hoc Committee is comprised of the following members: Virtus Capital Advisors, Hawk Opportunity Fund, Greenhill Capital Partners, LLC and Reservoir Capital Group, L.L.C.

Group Inc.[2] ("Crusader" and, together with its Chapter 11 debtor-affiliates, the "Debtors"),[3] by this motion (the "Motion"), seeks entry of an order under section 1102(a)(2) of title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code") and rules 2020 and 9014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") directing the United States Trustee for the Northern District of Texas (the "U.S. Trustee") to appoint an official committee of equity security holders (an "Equity Committee") in the Debtors' chapter 11 cases. In support of this Motion, the Ad Hoc Committee states as follows:

PRELIMINARY STATEMENT

1. The appointment of an Equity Committee in these chapter 11 cases is clearly justified and absolutely necessary to assure adequate representation of Crusader's equity security holders' interests. As described herein, the Debtors have substantial equity value based on their cash flow potential and intrinsic values underlying their oil and gas assets. As described in further detail below, application of 24-month NYMEX futures strip pricing to the Debtors' existing production levels reflects equity value in the $25-$50 million range, and accessing the Debtors' "shut in" reserves would produce an additional equity value in the $30-$60 million range, meaning that the Debtors' equity value could very well be in excess of $100 million. However, the Ad Hoc Committee does not need to show that the Debtors are solvent or that there is in fact substantial equity value; instead, they need only show that the Debtors are not "hopelessly insolvent". By any measure, whether from existing cash flow, projected cash flow,

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[2] The members of the Ad Hoc Committee, and such members' affiliates, together own or control approximately 60 million shares of common stock issued by Crusader, approximately 30% of the shares outstanding. At this time, each of the members of the Ad Hoc Committee is willing to serve on the Equity Committee (as defined below). A principal of Greenhill Capital Partners, LLC (Robert Niehaus) previously served as a member of the Board of Directors but resigned on July 9, 2009.

[3] The Debtors include Crusader Energy Group Inc., Crusader Energy Group, LLC, Hawk Energy Fund I, LLC, Knight Energy Group, LLC, Knight Energy Group II, LLC, Knight Energy Management, LLC, RCH Upland Acquisition, LLC and Crusader Management Corporation.

equity trading value, balance sheet, or otherwise, the Debtors appear to be solvent and are not in any sense "hopelessly insolvent".

2. Unfortunately, the Debtors are not taking appropriate steps to serve the interests of shareholders but instead have been acted solely for the benefit of creditors without regard to preserving or maximizing equity value. The creditor constituents are forcing a sale process, which the Debtors have effectively acquiesced to, at a time when third party offers may very well not reflect the true intrinsic value of the Debtors and their assets. The *Final Order Authorizing Use of Cash Collateral and Granting Adequate Protection* entered August 6, 2009 (the "Final Cash Collateral Order") includes conditions that require the Debtors to consummate a transaction within an extremely short timeframe – as described further below, the Debtors must file plan documents (whether a liquidating or reorganization plan) by the end of this month.

3. Therefore, appointment of an Equity Committee is necessary to provide shareholders with an appropriate voice in the reorganization process. Otherwise, any reasonable prospect for preserving equity value and obtaining a shareholder recovery will be lost because creditors are forcing a process which is focused on achieving recovery as quickly as possible, without regard for the impact on shareholders and whether reasonable alternatives might yield greater value over time.

JURISDICTION AND VENUE

4. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

5. This is a core proceeding pursuant to 28 U.S.C. § 157(b).

6. The predicates for the relief requested herein are section 1102(a)(2) of the Bankruptcy Code and Bankruptcy Rules 2020 and 9014.

BACKGROUND

7. On March 30, 2009 (the "Petition Date"), the Debtors each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code, thereby commencing the above-captioned bankruptcy cases. The bankruptcy filing was apparently triggered by the Debtors' inability to obtain a waiver of an alleged default in a $5 million borrowing base deficiency, which was a result of an unscheduled redetermination of the Debtors' borrowing base by the first lien lenders.

8. On April 14, 2009, the U.S. Trustee appointed an official committee of unsecured creditors (the "Creditors' Committee") and added an additional member on May 27, 2009. The Creditors' Committee currently consists of seven (7) members: Halliburton Energy Services, Inc., Trinidad Drilling, Global Geophysical Services, Inc., Goober Drilling LLC, Grey Wolf, Inc., WB Supply Co. and Smith International, Inc. On June 17, 2009, the Court entered a final order authorizing the Creditors' Committee to retain Gardere Wynne Sewell LLP as its counsel.

9. On July 22, 2009, Virtus Capital Advisors and Hawk Management sent a letter to the Assistant United States Trustee requesting the appointment of an official committee of equity security holders. A copy of the letter is attached hereto as Exhibit A. On July 24, 2009, the Assistant United States Trustee orally advised counsel that he was not going to grant the request.

10. The Ad Hoc Committee has had discussions with counsel for the Debtors since its submission of its letter, but those discussions have not led to any resolution.

RELIEF REQUESTED

11. The Debtors' equity security holders are entitled to, and the Ad Hoc Committee respectfully requests, pursuant to section 1102(a)(2) of the Bankruptcy Code and Bankruptcy Rules 2020 and 9014, the entry of an Order directing the U.S. Trustee to appoint an Equity Committee in these chapter 11 cases. Appointment of an Equity Committee is required to enable

equity security holders of the Debtors to participate fully, actively and appropriately in these cases and to ensure that they receive the value to which they are entitled under the chapter 11 process.

BASIS FOR RELIEF

12. Section 1102(a) of the Bankruptcy Code provides that "on request of a party in interest, the court may order the appointment of additional committees . . . of equity security holders if necessary to assure adequate representation of . . . equity security holders." 11 U.S.C. § 1102(a)(2). The bankruptcy court's determination of the need for an additional committee is unfettered and de novo, without regard to the U.S. Trustee's decision. *In re Enron Corp.*, 279 B.R. 671, 684 (Bankr. S.D.N.Y. 2002); *In re Texaco, Inc.*, 79 B.R. 560, 566 (Bankr. S.D.N.Y. 1987).

13. Congress recognized the vulnerability of public investors in Chapter 11 bankruptcy cases when it provided for the ability to seek appointment of additional committees of equity security holders in section 1102(a)(2) of the Bankruptcy Code.[4] 11 U.S.C. § 1102(a)(2). The legislative history of section 1102 indicates that Congress understood the important purpose an equity committee could serve "to counteract the natural tendency of a debtor in distress to pacify large creditors, with whom the debtor would expect to do business, at the expense of small and scattered investors." S. Rep. No. 95-989, at 10 (1978).

14. As a result, official committees of equity security holders have been appointed in many recent chapter 11 cases, including in this circuit and district. *See, e.g., In re Pilgrim's Pride Corp.*, Case No. 08-45664 (Bankr. N.D. Tex. 2008); *In re Gadzooks, Inc.*, Case No. 04-

[4] In enacting the Bankruptcy Code of 1978, Congress viewed reorganization proceedings as "literally the last clear chance to conserve for [shareholders] values that corporate financial stress or insolvency have placed in jeopardy." S. Rep. No. 95-989, at 10 (1978).

31486 (Bankr. N.D. Tex. 2004); *In re Mirant Corp.*, Case No. 03-46590 (Bankr. N.D. Tex. 2003); *In re Spectrum Jungle Labs Corp.*, Case No. 09-50455 (Bankr. W.D. Tex. 2009).

15. The Bankruptcy Code itself affords no test for determining "adequate representation" under section 1102. The analysis is determined on a case-by-case basis but courts have generally applied the following set of factors in analyzing the adequacy of a committee's representation:

(a) the debtor is not "hopelessly insolvent" so that shareholders appear to have a real economic interest at stake;

(b) the interests of the shareholders are not otherwise adequately represented;

(c) the case is large and complex;

(d) the stock is widely held and actively traded; and

(e) the timing of the request is appropriate.

See, e.g., In re Pilgrim's Pride Corp., 2009 WL 1231251, at *3 (Bankr. N.D. Tex. Apr. 30, 2009); *In re Williams Commc'ns Group, Inc.*, 281 B.R. 216 (Bankr. S.D.N.Y. 2002); *Albero v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 68 B.R. 155 (S.D.N.Y. 1986), *appeal dismissed*, 824 F.2d 176 (2d Cir. 1987). All of the criteria for the appointment of an Equity Committee under section 1102(a)(1) of the Bankruptcy Code are present in these chapter 11 cases.

A. <u>The Debtors Are Not Hopelessly Insolvent</u>

16. The Debtors are not "hopelessly insolvent" in any sense. Rather, it is quite clear from the Debtors' own financial information that there is current positive equity value in the Debtors and their assets and that the positive equity value could be quite substantial.

17. The applicable legal standard is not whether the Debtors are solvent, but rather whether the Debtors "appear to be hopelessly insolvent." *Williams Commc'ns*, 281 B.R. at 220-

21; *In re Emons Indus., Inc.*, 50 B.R. 692, 694 (Bankr. S.D.N.Y. 1985) ("[G)enerally no equity committee should be appointed when it appears that a debtor is hopelessly insolvent because neither the debtor nor the creditors should have to bear the expense of negotiations over the terms of what is in essence a gift"). Thus, an Equity Committee would theoretically be appropriate even if the Debtors appeared slightly insolvent. *See In re Wang Labs., Inc.*, 149 B.R. 1, 7 (Bankr. D. Mass. 1992) (appointing an equity committee even where the debtor had negative book equity of several hundred million dollars). "[T]here is no clear litmus test" in determining a debtor's solvency. *Williams Commc'ns*, 281 B.R. at 220. Instead, it is a "practical conclusion, based on a confluence of factors." *Id.* at 221.

18. The appropriate standard for valuing a chapter 11 debtor was set out by the Supreme Court in *Consol. Rock Prods. Co. v. Du Bois*, 312 U.S. 510 (1941), where the court made it clear that cash flow, not book value determines solvency: "The criterion of earning capacity is the essential one. . . ." *Id*. at 526; *see also Pilgrim's Pride Corp*., 2009 WL 1231251, at *4 ("The value of the Debtors will ultimately be determined on their ability to generate cash flow"); *In re Mirant Corp.*, 334 B.R. 800, 816 (Bankr. N.D. Tex. 2005) ("The court has found in numerous opinions support for valuation of a chapter 11 debtor through the use of the DCF Method and the Comparable Method. The court finds these methods of valuation the most likely to ensure that Mirant Group is valued based on the worth of its future ability to produce income.") (citations omitted). A further indication of solvency is when a debtor's shares are still actively trading and the debtor remains in operation, *see Wang Indus.*, 149 B.R. at 3, both of which are true here.

19. Here, the following facts (some of which are reflected in the Debtors' own statements and filings) clearly establish that the Debtors are not hopelessly insolvent, and in fact that the Debtors are actually solvent and in all likelihood materially so:

- Importantly, the Debtors' operations and assets remain fundamentally sound. As described in the *Affidavit of Roy A. Fletcher in Support of First Day Pleadings and Papers* dated March 30, 2009 (the "Fletcher Affidavit"), attached hereto as Exhibit B, the Debtors' bankruptcy filing was a direct consequence of a $5 million borrowing base deficiency that resulted from an "unscheduled redetermination" of the Debtors' borrowing base by the first lien lenders. Fletcher Affidavit ¶¶ 12-14. Additionally, as of the Petition Date, the Debtors' revenues and cash flows were depressed by the "historic declines in the prices of crude oil and natural gas since the summer of 2008." *Id.* ¶ 14. The Debtors thus faced a short-term liquidity problem that forced them to file. The filing was not a result of any operational or asset problem or concern.

- The Debtors' originally filed schedules dated May 6, 2009 reflected, as of the March 31, 2009 petition date, approximately $335 million of assets and $353 million of liabilities. While this indicates a small deficiency, the assets are 95% of the liabilities, showing a near solvent level and unquestionably falling far short of "hopeless insolvency". Moreover, the Debtors amended their schedules on May 30, 2009 and supplemented their assets to include net acres of leasehold with proved developed producing reserves aggregating approximately $126 million (premised on low March 2009 oil and gas prices). This, taken together with the assets identified in the originally filed schedules, evidences material equity value in the Debtors' assets. Further, Crusader's monthly operating reports for June 2009 (filed on July 22, 2009), attached hereto as Exhibit C, reflects asset values of $345.8 million and total liabilities had fallen to $342.3 million, again illustrating positive equity value acknowledged by the Debtors.

- Crusader's last-filed Form 10Q for the quarter ended September 30, 2008, attached hereto as Exhibit D, which reflected activity before the substantial decline in oil and gas prices, stated substantial equity value of $424 million. On September 30, 2008, the spot oil price was $100.64; by May 31, 2009, oil prices were $66.31, a decline of -34.1%. Natural gas was $7.18 on 9/30/08 and $3.92 on 5/31/09, a decline of -45.4%. Yet, Crusader reported in its June 2009 monthly operating report, equity value of only $3.4 million, a decline of 99.2%, an amount substantially greater than the corresponding drop in the underlying commodity prices. This overly dramatic drop in value cannot be rationalized and suggests analyses by the company are possibly being skewed to the detriment of shareholders. As prices rebound, as they have been doing over the past eight weeks, that increase in value should accrue to the direct benefit of shareholders.

- Crusader's June 2009 monthly operating report shows "Prepetition Owners' Equity" of $18.1 million as of June 30, 2009 and "Total Equity" of $3.4 million as of June 30, 2009. The May 2009 monthly operating report, attached hereto as Exhibit E, shows $18.1 million of "Prepetition Owners' Equity" as of May 31, 2009 and "Total Equity" of $7.4 million.

- Crude oil and natural gas prices have strongly rebounded since the period leading up to and as of the Petition Date: Significantly, spot oil traded/prices on the NY Mercantile Exchange (NYMEX) averaged $43.30 per barrel (bbl) from January 1, 2009 through March 31, 2009, while in the four months following the Petition Date (April 1 through July 31), oil averaged $61.00, an increase of approximately 41%. But, today's spot trading prices do not reveal the full picture regarding long-term value. A review of the supply and demand dynamics that drive industry pricing shows that in September 2008 there were 1,606 natural gas drilling rigs operating across the United States; that number fell to 665 rigs as of July 17, 2009. Bloomberg News, *U.S. Gas Rigs Drop to 7-Year Low, Baker Hughes Says*, July 17, 2009, attached hereto as Exhibit F. This 59% decline in the rig count should lead to materially lower gas production and thus higher prices in the near future. Further, most industry analysts expect that as the economy recovers, an increased demand for natural gas will lead to higher prices. Bloomberg News, *Gas Market to 'Tighten' on Demand, Bernstein Says*, July 2, 2009, attached hereto as Exhibit G.

- The NYMEX futures pricing for crude oil and natural gas clearly evidences these anticipated increases. While the NYMEX price for crude oil to be delivered in August 2009 is $59.73, the NYMEX price for delivery in August 2010 is $67.38, an approximately 13% increase in just one year. While the NYMEX price for natural gas delivered next month is $3.42, the NYMEX price for gas delivered one year later is $5.68, an approximately 66% increase in just the next twelve months. Based on these dramatic price increases, Crusader clearly has much greater value if preserved as a going concern for the next twelve months. The present and futures pricing dramatically enhance the Debtors' value and cash flow beyond the bottomed-out levels existing as of the Petition Date. By the time the August 2010 pricing is achieved the Debtors will have substantial equity value.[5] (Pricing data was obtained from Bloomberg on July 16, 2009).

- Current pricing in the NYMEX futures markets (which can be locked in today) shows that the expected increase in value should continue for many, many years into the future. For example, going out five years, the NYMEX

[5] Crusader has the ability to take advantage of this future pricing by selling forward its production to realize today the existing built-in value of its oil and gas. The Ad Hoc Committee is not necessarily advocating that approach, but notes it to highlight the very real increased value that exists as a consequence of the increase in future pricing.

price for oil delivered in August 2014 is $80.58, which is approximately 35% higher than the current spot price. Likewise, the NYMEX price for natural gas five years from now in August 2014 is $6.92 which is approximately 102% higher than today's spot price. Clearly, therefore, the longer this company is preserved as a going concern, the more value will accrue to all stakeholders.

- Crusader's May 2009 monthly operating report shows EBITDA of $3.3 million in May, despite oil and gas prices remaining at low levels. The June 2009 operating report reflected EBITDA of $3.6 million for June. The 24-month NYMEX futures strip price for Henry Hub natural gas was $5.95 on July 1, 2009, which is 55.4% higher than the $3.83 average daily price Crusader was likely receiving in May 2009. Based on that pricing increase, and assuming the Debtors' current daily production remains at 34,000 mcfe/day, the Debtors' EBITDA should increase significantly and would project based on the May results to be in the range of $60 to $70 million per year, a level which highlights the Debtors' earning capacity and actual solvency. At a conservative 5x multiple, $70 million of annual EBITDA implies an enterprise value of at least $350 million and net equity value of $25 to $50 million (depending on the cash build and level of claims pay-down). At that level, the Debtors should be able to achieve a successful stand-alone reorganization and would have sufficient cash flow to service their debt and fund capital expenditures while maintaining material equity value. For example, at an EBITDA run-rate of $70 million, Crusader could likely obtain and support debt of $250 million to $300 million while paying off its trade claims from operating cash flow. The debt should have annual interest charges of $30 million or less; leaving $40 million of cash flow to support capital expenditures of $25 to $30 million which leaves $10 million to $15 million of additional cash flow to amortize debt and create value for equity holders.

- Similarly, the budget attached to the June 16, 2009 order authorizing the Debtors to use cash collateral (the "Third Cash Collateral Order") indicates that net cash flow from operations is projected to be $7.4 million in the two month period between May 25, 2009 and July 20, 2009. This would annualize to $44 million of net cash flow. Application of futures pricing could almost double the Debtors' projected net cash flow. According to a November 6, 2008 press release, Crusader's daily production was approximately 34,000 thousand cubic feet equivalents (mcfe). With the 5-year forward price strips for gas and oil approximately $3.00 per mcfe higher than current pricing, it is clear that Crusader's current production is capable of generating an additional $37 million a year in annual cash flow above the current run-rate of $44 million per year. (The math is 34,000 mcfe x 365 days x $3.00/mmcfe = $37.2 million). Adding this additional $37 million of increased cash flow from higher prices to the current run-rate of $44 million of cash flow would put Crusader's annual EBITDA at an $81 million run-rate further demonstrating the substantial equity value in the company.

- It is also noteworthy that the Debtors' cash on hand has grown from $6.9 million on the Petition Date to $18.5 million in three months. *See* Crusader's May 2009 monthly operating report and June 2009 monthly operating report; Debtors' Schedules of Assets and Liabilities. An ability to generate cash, despite low commodity prices, at an annual run-rate of $70 million a year shows the company can support itself in bankruptcy while increasing stakeholder value and further illustrates the Debtors' ability to continue as a going concern.

- According to their public filings, during the year prior to the Petition Date, the Debtors had embarked on an aggressive drilling program. A common industry practice is to drill for gas while waiting to confirm success of the well before negotiating for pipeline access. Natural gas, unlike oil, can not be carried out in trucks but must be transported via local "gathering" pipelines which are then aggregated into the major pipelines which transport gas across the United States. The Debtors, based on their increases in their Proved reserve levels, appears to have several successful well completions but have not shown the corresponding increases in production flows. It appears that Crusader has been unable to pay to build out the pipeline hook-up into the gathering system due to restrictions on capital expenditures perhaps imposed by creditors. The effect is that Crusader – based on drilling activity and increases in Proved reserves – likely has an additional 10% to 20% of production volume that is "shut in". These shut-in volumes are an untapped asset with great value potential. If accessed, these reserves could add 5,000 to 10,000 mcfe/day, resulting in between $500,000 to $1,000,000 of cash flow a month and an additional $6 million to $12 million in EBITDA per year. This reflects additional equity value of $30 million to $60 million at a conservative 5x multiple.[6]

- As reported in Crusader's Form 10-Q, in the third quarter of 2008, the Debtors had $24 million of EBITDA which annualizes to $96 million and reflects substantial equity value (approximately $200 million) even at a conservative 5x multiple. Because it was the substantial oil and gas price declines which drove down the Debtors' EBITDA during the first half of 2009, rebounding prices should enable the Debtors to achieve or come close to their prior EBITDA levels, particularly if the Debtors' management is permitted to manage the company in a manner that will allow the maximization of value for all stakeholders.

- Upon information and belief, based on the existing 5-year forward price strips for gas and oil, the Debtors' Proved Developed Producing Reserves - PV10% are valued in excess of $500 million, again evidencing substantial equity value.

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[6] As described below, the Debtors' recent effort to open up some of its reserves was faced with creditor opposition despite the long-term enhancement to the Debtors' asset value.

20. These facts clearly establish that the Debtors' assets have substantial equity value and that the Debtors are not "hopeless insolvent" in any sense or by any means, whether based on cash flow, book value or otherwise.

B. The Interests of Equity Will Not Be Adequately Represented Without an Equity Committee

21. The Equity Committee should be appointed because the interests of Crusader's shareholders are not otherwise adequately represented in these chapter 11 cases. Without an Equity Committee, there is no constituency responsible or incented to protect, maintain and maximize the positive value of the equity.

22. Although unsecured creditors and shareholders possess a shared interest in seeing that the unsecured creditors are paid, such interests are not always aligned and often diverge. *See Pilgrim's Pride Corp.*, 2009 WL 1231251, at *4, n.17 ("While . . . shareholders and unsecured creditors often have common interests . . ., when it comes to valuation . . ., their agendas are likely to be very much at odds."); *In re Evans Prods. Co.*, 58 B.R. 572, 575 (S.D. Fla. 1985) ("[t]he interests of creditors and shareholders are likely to conflict over the course of a Chapter 11 proceeding"); *In re Saxon Indus., Inc.*, 29 B.R. 320, 321 (Bankr. S.D.N.Y. 1983) (unsecured creditors committee and equity committees "are separate and distinct entities with the members . . . possessing variant priorities and interests with respect to their relationship with the debtor"). Importantly, the Creditors' Committee owes fiduciary duties only to unsecured creditors -- not to the estates as a whole, and certainly not to equity holders. Similarly, the first and second lien lenders are acting in their own interests and not for the benefit of the equity holders.

23. Neither the lenders nor the Creditors' Committee has any incentive to choose strategic alternatives that maximize value for equity.[7] In fact, the lenders' and the Creditors' Committee's interest here may very well be to effect a quick sale of the Debtors' assets at a time when the sale value may be depressed due to the unprecedented recent decline in oil and gas prices, but remain at a high enough level to just eke out a recovery that pays out the creditors in full or substantially close thereto.

24. Almost exactly one year ago in July 2008, spot oil traded at $145.29 per barrel and natural gas traded at $13.31 per mcf. Oil subsequently collapsed to a low of $33.98 per barrel, an approximately 77% decline which is the largest and fastest price decline in more than 30 years, and was worse than the decline in oil in the early 1980s after events of the mid-1970s Arab Oil embargo calmed down. The decline in natural gas prices is similarly historic in its fall in price from $13.31 to $3.42, an approximately 74% decline. Therefore, rushing to sell oil and gas assets in the face of such an unprecedented decline seems ill-conceived and harmful in preserving value for all stakeholders.

25. Nonetheless, both the Creditors Committee and the second lien lenders appear to be advocating that approach. Each has filed an objection dated July 17, 2009 to the Debtors' Exclusivity Motion (as defined below) advocating a much shorter extension, evidencing their goal of forcing an immediate sale or reorganization while values are in a trough. The second lien lenders have opposed the Debtors' motion to use cash collateral unless extremely short deadlines

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[7] By way of example, the Creditors Committee has opposed the Debtors' motion to approve well elections because it was not clear whether the creditors would benefit from the Debtors' proposed expenditure of funds (approximately $2.26 million) regardless of whether there may otherwise be a benefit to the reorganized Debtors. Omnibus Objection of the Official Committee of Unsecured Creditors to (1) Debtors' Expedited Motion to Approve (A) Well Elections with Chesapeake Exploration, L.L.C. and (B) Future Well Elections with Parties to Oil and Gas Agreements and (2) Expedited Motion to Approve Well Elections with Alpine Energy, L.P., Alpine, Inc., and K2X Operating, L.P. dated July 16, 2009. Both motions were approved by the Court. *See* Docket Nos. 519, 522.

are imposed for the filing of a plan of reorganization (*i.e.*, by August 15, 2009), the adoption of sale procedures, approval of a sale and confirmation of a plan of reorganization. And the Debtors have now effectively agreed to that approach. The Final Cash Collateral Order conditions the cash collateral usage upon the Debtors' consummation of a sale or "reorganization" transaction within an extremely short time-frame. Specifically, the Debtors must file a motion seeking approval of bid procedures by August 21, a mere 14 days from today. If the Debtors proceed with a sale, they must file a plan of liquidation by August 31, obtain approval of a disclosure statement by October 2 and obtain approval of the sale and plan of liquidation by November 9. And if the Debtors proceed with a "reorganization" plan, there are similar aggressive milestones that must be met: file a plan by August 21, obtain approval of a disclosure statement by September 22 and obtain approval of the transaction pursuant to the plan by October 28. And the so-called "reorganization" plan is apparently predicated on a sale transaction because it is predicated on the immediate adoption of bid procedures.

26. The Debtors' directors and management also cannot adequately protect the shareholders' interests. Outside of bankruptcy, the Debtors' directors and management may singularly focus on their shareholders' interests. But inside bankruptcy, the Debtors' directors and managers have broad-based fiduciary responsibilities to the estates as a whole, but not to equity holders alone. *See Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985). During a bankruptcy case, conflicting concerns often arise which make it difficult for such directors and management to follow the best course for equity holders. *See Pilgrim's Pride Corp.*, 2009 WL 1231251, at *5 ("The dynamics of chapter 11 are such that Debtors-and their management-are likely to be constrained to accept and advocate to the court a conservative value for their business in order to obtain creditor assent to a reorganization plan.")

27. The Debtors' recently-filed motion to extend its exclusivity period under Section 1121(d) of the Bankruptcy Code dated June 26, 2009 (the "Exclusivity Motion") highlights the fact that the Debtors and their directors and management are focused principally, if not entirely, on creditor interests. In the Exclusivity Motion, the Debtors noted that they had made good progress negotiating with their creditors and that they had been in regular "conference and consultation" with the lenders and the Creditors' Committee. Exclusivity Motion ¶ 16. Conspicuously absent is any mention of the Debtors' discussions or efforts to involve shareholders in the process. To our knowledge, no such discussions or efforts have occurred.

28. By order dated July 13, 2009 (the "MIP Order"), the Debtors obtained approval of a management incentive program (the "MIP Program"). Pursuant to the MIP Program, the Debtors' top 4 officers and managers (President and CEO, Secretary and General Counsel, Vice President and Engineering Manager and VP-Controller/Investor Relations) are eligible to receive a bonus based on the proceeds of the sale of the Debtors' assets or capital stock. The bonus is equal to 1% of the aggregate transaction value minus $160 million. However, no bonus is payable if the transaction value is $200 million or less, and further no bonus is payable on transaction value in excess of $300 million. *See* MIP Order at 1-2. As structured, the Debtors' management has been incented to sell the assets as quickly as possible and without regard to maximizing the value of the assets. So long as the sale value is at least $300 million, management receives the maximum bonus. Moreover, the Debtors' motion for approval of the MIP Program (the "MIP Motion") noted that "many interested bidders have already expressed a desire to retain current management after any Sale." *See* MIP Motion ¶ 12. As a consequence, management has no economic incentive to hold out or delay the sale process even if more time may generate a substantially higher sale price than $300 million, including one which would

yield value for shareholders. As a consequence, management cannot be said to be adequately representing the interests of shareholders.[8] And as reflected in the Final Cash Collateral Order, the Debtors have acquiesced to conducting a sale process over the next few weeks, without regard to whether alternatives might yield greater value for all stakeholders.

29. The shareholders are entitled to an official role in these chapter 11 cases to advance and preserve equity value. An Equity Committee can effectively help protect the interests of shareholders in connection with any sale or restructuring process to insure that the process is run appropriately and not with an eye towards achieving a quick recovery at bottomed-out prices, as well as in connection with the general restructuring negotiations which to date have excluded shareholder participation. Shareholder exclusion without official representation will continue to hamper shareholders' ability to effectively participate in these chapter 11 cases through a practical lack of access to management and other necessary resources from the Debtors. Now is an essential time for the shareholders to be represented because the Debtors are now obligated to begin a sale process in the next few weeks – a process which, as a practical matter, will lock in values and may potentially shut out shareholders from participating in recoveries.

C. <u>These Chapter 11 Cases are Large and Complex</u>

30. There is no question that the Debtors' chapter 11 cases are large and complex. As indicated by the Debtors' own filings, these cases involve significant assets, numerous creditor constituencies and hundreds of millions of assets and liabilities. The Debtors hold leases covering approximately 1,000,000 gross acres (440,000 net acres) of oil and gas property

[8] Upon information and belief, the Debtors lease their office space from an entity owned by the Debtors' Chief Executive Officer, David LeNorman. While it is possible that this lease is at market rates, the Debtors have dramatically scaled down their management team since the Petition Date and it thus seems likely there may be excess space on hand. However, it does not appear that the Debtors' management or any creditor has raised the issue of rejecting or paring down this lease.

(including approximately 12,800 drilling locations), operate approximately 350 wells, and hold working interests in approximately 670 wells. Additionally, the Debtors are party to approximately 13,300 oil and gas leases and numerous other agreements, including executory contracts and unexpired leases. There have been hundreds of filing in these chapter 11 cases, which is another indicia of complexity. *See Wang Indus.*, 149 B.R. at 3. Further, in the Exclusivity Motion, the Debtors acknowledged that their cases are large and complex. Exclusivity Motion ¶ 14.

31. In *Pilgrim's Pride Corp.*, the District Court for the Northern District of Texas noted that the complexity of a case may even concern the difficulty management will have making decisions for the business that benefit both the creditors and equity holders, thus warranting the appointment of an equity committee. 2009 WL 1231251, at *6. Here, the Debtors are facing tremendous pressure from their creditors (including an impending deadline tied to their use of cash collateral) to move forward with a quick sale process, without regard to whether that process will maximize value or is the best interests of all stakeholders including shareholders.

D. <u>The Stock is Widely Held and Actively Traded</u>

32. Crusader stock is widely held and actively traded. Crusader began trading on the American Stock Exchange under the ticker symbol "KRU" on June 27, 2008, and traded on the New York Stock Exchange until it was de-listed after the Petition Date. Today, Crusader stock trades under the ticker symbol "CKGRQ" and has average trading volume of 93,000 shares a day since it resumed trading on April 13, 2009. (Source: Bloomberg). As of September 30, 2008, Crusader had more than 198,664,746 shares of common stock outstanding and 181 shareholders. *See* Voluntary Petition of Crusader Energy Group Inc., Exhibit A. According to Bloomberg, approximately 90% of the shares are held by institutional investors and the public. The number

of shareholders is a bit misleading as many shareholders hold their stock in "street name" and therefore are aggregated as holders under one broker firm's name; but the shareholder base is widespread and the number of actual outstanding shares is significant. Since the stock reopened for trading since the Petition Date, over 7 million shares have traded, providing evidence of an active market for the common stock. No single shareholders is responsible for, nor likely able to afford, advocating for a sale that maximizes value for all interest and equity holders in the face of anticipated stiff opposition from the Debtors and their management, directors and creditors.

E. <u>This Request Comes on a Timely Basis</u>

33. Although these chapter 11 cases remain in their early stages, it is our understanding that the Debtors are seriously exploring sale offers and may be intending to move ahead with a stalking horse bid within the next several weeks. The Ad Hoc Committee is particularly concerned that the Debtors may be rushing headlong into a sale process, at a time when sale values have bottomed out and may not yield the highest value for the assets.

34. Further, this case differs from many other bankruptcies as there has been no material diminution in value or adverse effect on operations as a result of the bankruptcy process, and therefore speed in exiting bankruptcy is not crucial from a value or operations standpoint. In fact, there is a great likelihood that substantial equity value can be realized by allowing the developing rebound in oil and gas prices to occur rather than rushing into a premature sale. Moreover, as detailed above, the Debtors have been able to accumulate cash during the cases.

35. As a result, these chapter 11 cases are approaching a very critical juncture which may have irrevocable and detrimental consequences for the ultimate recovery values in these chapter 11 cases for the Debtors' creditors and shareholders. It is thus a ripe time point for the Equity Committee to be appointed so that it can function in connection with any sale process,

any related or separate restructuring discussions and any other discussions and negotiations regarding the maximization and allocation of value in these chapter 11 cases.

36. In contrast, it cannot be said that it is too late for the Equity Committee to become involved or that involvement at this point would cause meaningful delay in the cases. The cases were filed just over 90 days ago and as indicated in the Exclusivity Motion, the Debtors are still "exploring various sale and plan alternatives" and "need more time to evaluate (and obtain input from the *[sic]* their first and second lienholders and the Committee) with respect to their alternatives." Exclusivity Motion ¶ 17. There is ample time for the Equity Committee to be meaningfully involved and represented effectively in the administration of the estates and the reorganization process including any potential asset sales. Accordingly, this request is timely.

F. Cost of Additional Committee is De Minimis Given the Compelling Need for Adequate Representation of the Company's Equity Security Holders

37. The Ad Hoc Committee is certainly mindful of concerns regarding the additional expense associated with the formation of an Equity Committee, but "[c]ost alone cannot, and should not, deprive . . . security holders of representation." *In re McLean Indus., Inc.*, 70 B.R. 852, 860 (Bankr. S.D.N.Y. 1987). Courts typically "employ a balancing test to weigh the cost of an equity committee versus the 'concern for adequate representation.'" *Williams Commc'ns*, 281 B.R. at 220. Once the need for adequate representation is established, "the burden shifts to the opponent of the motion [to appoint an official equity committee] to show that the cost of the additional committee sought significantly outweighs the concern for adequate representation and cannot be alleviated in other ways." *In re Beker Indus. Corp.,* 55 B.R. 945, 949 (Bankr. S.D.N.Y. 1985).

38. Additionally, the Bankruptcy Code contains adequate means for controlling costs. *See* 11 U.S.C. § 330(a)(1). The Bankruptcy Code prohibits courts from compensating

professionals for "unnecessary duplication of services; or services that were not reasonably likely to benefit the debtor's estate; or necessary to the administration of the case." 11 U.S.C. § 330(a)(4)(A). Costs may be reviewed by the Debtors, the Creditors' Committee and the U.S. Trustee, and, ultimately, will be subject to allowance in the bankruptcy court's discretion. In a case where there is clear equity value but inadequate representation for shareholders, the benefits of committee representation of shareholders' interests far outweigh any additional costs to the Debtors' estates.

NOTICE AND PRIOR MOTIONS

39. Notice of this Motion has been given to (a) counsel to the Debtors, (b) the U.S. Trustee, (c) counsel to the Creditors' Committee, and (d) all other persons that have formally appeared and requested service in these chapter 11 cases.

40. In light of the nature of the relief requested, the Ad Hoc Committee submits that no other and further notice of this Motion is necessary or required.

41. No previous request for the relief sought herein has been made to this or any other Court.

[Signature Page Immediately Follows]

CONCLUSION

WHEREFORE, the Ad Hoc Committee respectfully requests that the Court enter an order, substantially in the form attached hereto as Exhibit H, (a) directing the U.S. Trustee promptly appoint an official committee of equity security holders and (b) granting such other and further relief as it deems is just and proper under the circumstances.

Dated: August 10, 2009
Dallas, Texas

Respectfully submitted,

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Co-Counsel for the Ad Hoc Committee of Equity Security Holders

CERTIFICATE OF SERVICE

A true and correct copy of the foregoing document was served on August 10, 2009, upon the counsel for the Debtors, the Office of the United States Trustee, the Official Committee of Unsecured Creditors, all parties on the attached Master Service List, and all persons who have filed a notice of appearance and request for service of pleading in the chapter 11 cases via ECF Electronic Notice. A true and correct copy of the foregoing document was served on August 11, 2009, via first class, U.S. mail, postage prepaid, upon the above mentioned parties who do not receive ECF Electronic Notice.

/s/ C. Josh Osborne
C. Josh Osborne