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

IN RE §
§
CANO PETROLEUM, INC., ET AL. § **CASE NO. 12-31549-BJH**
§ **JOINTLY ADMINISTERED**
§ **REQUESTED**
§
Debtors. § **(CHAPTER 11)**

EMERGENCY MOTION TO (A) APPROVE PRE-PETITION WAGES, SALARIES AND PAYROLL TAXES; (B) REIMBURSE EMPLOYEES FOR PRE-PETITION BUSINESS EXPENSES; AND (C) HONOR EXISTING BENEFIT PLANS AND POLICIES AT THEIR DISCRETION IN THE ORDINARY COURSE OF BUSINESS

THE DEBTOR HAS REQUESTED EMERGENCY CONSIDERATION OF THIS MOTION AND HAS REQUESTED THAT A “FIRST DAY” HEARING BE HELD ON THIS MOTION AT THE COURT’S EARLIEST CONVENIENCE. IF THE COURT IN FACT SETS THIS MOTION FOR AN EMERGENCY OR AN EXPEDITED “FIRST DAY” HEARING, THEN ONLY ATTENDANCE AT THE HEARING IS NECESSARY TO PRESERVE YOUR RIGHTS.

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Cano Petroleum, Inc. (“Cano”) and its direct and indirect subsidiaries, as debtors and debtors-in-possession (collectively, the “Debtors”)¹ file this *Emergency Motion to (A) Approve*

¹ The Debtors include Cano Petroleum, Inc., Cano Petro of New Mexico, Ladder Companies, Inc., Square One Energy, Inc., Tri-Flow, Inc., W.O. Energy of Nevada, Inc., W.O. Operating Company, Ltd., W.O. Production Company, Ltd., and WO Energy, Inc.

Pre-Petition Wages, Salaries and Payroll Taxes; (B) to Reimburse Employees for Pre-Petition Business Expenses; and (C) to Honor Existing Benefit Plans and Policies at Their Discretion in the Ordinary Course of Business (the “Motion”). In support of this Motion, the Debtors incorporate the *Declaration of James R. Latimer, III in Support of Voluntary Petitions, First Day Motions, and Designation as Complex Bankruptcy Case* (the “Latimer Declaration”).

Jurisdiction and Procedural Background

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157. This matter is a core proceeding pursuant to 28 U.S.C. § 157.

2. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

3. The statutory predicate for relief requested in this Motion is 11 U.S.C. §§ 363(b)(1) & 105(a), as complemented by Rule 6003 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

4. On March 7-8, 2012 (March 7, 2012 being the “Petition Date”), the Debtors each filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the “Bankruptcy Code”), thereby commencing these chapter 11 cases (collectively, the “Cases” or the “Case”).

5. Since the Petition Date, the Debtors have continued to operate and manage their businesses as debtors-in-possession pursuant to Bankruptcy Code §§ 1107 and 1108.

6. The Office of the United States Trustee (the “U.S. Trustee”) has not appointed an official committee of unsecured creditors in this Case.

7. Contemporaneously with the filing of this Motion, the Debtors filed their *Emergency Motion to Jointly Administer Chapter 11 Cases* and their *Request for Emergency Consideration of “First Day” Matters*.

Factual Background

8. The Debtors operate in the oil and natural gas industry and their business strategy historically has included developing and acquiring interests in mature oil fields with established primary and/or secondary reserves that may possess significant remaining upside exploitation potential by implementing various secondary and/or tertiary enhanced oil recovery techniques.

9. The Debtors have been in business for approximately eight years. Cano initially started as Huron Ventures, Inc. ("Huron"). After Huron merged with Davenport Field Unit Inc. and other entities in May of 2004, Huron changed its name to Cano.

10. Cano is the parent company to (a) Cano Petro of New Mexico ("Cano New Mexico"), a Texas corporation; (b) Ladder Companies, Inc. ("Ladder"), a Delaware corporation; (c) Square One Energy, Inc. ("Square One"), a Texas corporation; (d) Tri-Flow, Inc. ("Tri-Flow"), an Oklahoma corporation; (e) W.O. Energy of Nevada, Inc. ("W.O. Nevada"), a Nevada corporation; (f) WO Energy, Inc. ("WO Energy"), a Texas corporation; (g) W.O. Operating Company, Ltd. ("W.O. Operating"), a Texas limited partnership; and (h) W.O. Production Company, Ltd. ("W.O. Production"), a Texas limited partnership.

11. Cano is a publicly-traded company incorporated in Delaware and its common stock was listed on the NYSE Amex under the trading symbol "CFW." As of January 17, 2012, Cano voluntarily delisted its stock and is currently trading on the OTC Market Place operated by the OTC Markets Group under the symbol "CANO."

12. The Debtors' workforce, which at one time consisted of approximately 50 employees, now consists of only 27 part-time and full-time employees and 14 contract workers. Nearly all workers at the executive corporate level are independent contractors. After recent departures, the Debtors' Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO")

were replaced with new management, which is committed to maximizing the value of the Debtors' assets and businesses.

13. The Debtors' operations and assets are located onshore in the United States, in Texas, New Mexico, and Oklahoma. The Debtors have five principal producing properties which are located in: (a) Carson, Gray, and Hutchinson Counties, Texas (the "Texas Panhandle Properties"); (b) Nowata County, Oklahoma (the "Nowata Properties"); (c) Chavez and Roosevelt Counties, New Mexico (the "Cato Properties"); (d) Lincoln County, Oklahoma (the "Davenport Properties"); and (e) central Texas (the "Desdemona Properties").

14. The Debtors' oil and gas business depends heavily on the availability of capital and liquidity. Substantial capital expenditures are needed for the exploitation and the development of crude oil and natural gas reserves. The Debtors' current liquidity constraints have all negatively impacted the Debtors business and their ability to meet their obligations to secured lenders and trade creditors. As of September 30, 2011, the Debtors reported total assets of approximately \$63.4 million and total liabilities of approximately \$116.3 million on their unaudited and unreviewed consolidated balance sheets.

15. On December 17, 2008, the Debtors entered into a \$120.0 million Amended *and Restated Credit Agreement* (the "Senior Secured Debt" or the "Senior Credit Agreement") with Union Bank, N.A. ("Union" or the "Senior Pre-Petition Agent") and Natixis (together with Union, the "Senior Secured Lenders"). The Senior Secured Lenders contend that the current amount outstanding under the Senior Credit Agreement is \$60.6 million, with no further borrowing capacity.

16. The Senior Credit Agreement required the Debtors to hedge certain risks relating to oil and gas productions, namely protections against commodity price fluctuations and interest

rate fluctuations on the Senior Secured Debt. Consequently, the Debtors entered into certain commodity swap contracts. Due to the termination of certain commodity hedges and an interest rate hedge on August 22, 2011 and September 9, 2011, respectively, the Debtors owe an additional \$3.8 million in Senior Secured Debt.

17. On December 17, 2008, the Debtors also entered into a \$25 million Subordinated Credit Agreement (the “Junior Credit Agreement”) with UnionBanCal Equities, Inc. (“UBE” or the “Junior Pre-Petition Agent”), as the Administrative Agent. UBE asserts that the Debtors currently owe \$16.6 million under the Junior Credit Agreement (the “Junior Secured Debt”).

18. The Senior Secured Debt and the Junior Secured Debt are secured by substantially all of the Debtors’ assets. The Debtors are in default under the Senior Credit Agreement and the Junior Credit Agreement (collectively, the “Credit Agreements”).

19. The Debtors’ declining revenues, continued losses, borrowing constraints, loan defaults and limited-to-no capital availability forced the Debtors to drastically reduce costs, replace management and hire financial advisors to assist in a strategic process.

20. After a lengthy marketing process and substantial discussions with the Pre-Petition Lenders, the Debtors entered into a *Stock Purchase Agreement* dated March 7, 2012 (the “Stalking Horse SPA”) with NBI Services, Inc. (the “Stalking Horse”). In accordance with the Stalking Horse SPA, the Debtors agreed to sell and the Stalking Horse agreed to buy all newly-issued stock in Cano under a plan of reorganization for \$47.5 million in cash, subject to higher and better offers through a competitive auction process (the “Bidding Process”).

21. Contemporaneously with the execution of the Stalking Horse SPA and the negotiation of a motion to approve bidding procedures (the “Bid Procedures Motion”), the

Debtors, along with the Pre-Petition Lenders and the Stalking Horse, entered into that certain *Plan Support and Lock-Up Agreement* dated March 7, 2012.

22. The Debtors filed these Cases to effectuate a sale of their equity interests and/or assets. The filing of these Cases and the confirmation of the Plan are the Debtors' best option to preserve and maximize the value of their assets and businesses.

23. Additional information regarding the Debtors' businesses, the Stalking Horse SPA, the Plan (including the treatment of all claims), the Bidding Process, and the events leading to these Chapter 11 Cases is contained in the Latimer Declaration.

The Debtors' Employees

24. The Debtors' workforce consists of 27 salaried part-time and fulltime employees (the "Salaried Employees") and 14 contract workers (the "Contractors" and, with the Salaried Employees, collectively, the "Employees"). Attached as **Exhibit A** to this Motion is a list of the Employees as of the Petition Date.

Relief Requested

25. The Debtors are not permitted to pay pre-petition wage and other employee claims, absent specific court authorization. By this Motion, the Debtors seek authorization to:

(a) pay any and all pre-petition wages due to their employees for work preformed pre-petition, whether accrued or currently due and payable (collectively, the "Compensation Obligations");

(b) honor any and all of Debtors' pre-petition employee benefit obligations (the "Benefit Obligations"), including but not limited to, insurance payments, 401(k) matches, cell phone plans, credit cards, and any benefit premiums incurred in connection with the various Benefit Obligations (the "Benefit Programs");

(c) continue paying the Compensation Obligations, Benefit Obligations, Employee Reimbursement Obligations, Payroll Tax Obligations (as defined

below) and all fees and costs incident to the foregoing, including amounts owed to third-party administrators, governmental authorities (collectively, the “Employee Obligations”); and (d) continue administering all of the Employee Obligations in the ordinary course of business, at their discretion.

26. Additionally, the Debtors seek an order directing all relevant banks and financial institutions (collectively, the “Disbursement Banks”) to receive, process, honor and pay any and all checks, electronic fund transfers and automatic payroll transfers drawn on the Debtors’ bank accounts (collectively, the “Disbursement Accounts”), whether such checks were presented or fund transfer requests were submitted before or after the Petition Date, to the extent that such checks or transfers related to any of the Employee Obligations.

27. With the relief sought in this Motion, the Debtors seek to minimize the personal hardship that would be visited on their Employees if they are not paid when due and to maintain the morale of their essential workforce at this critical time. Due to the potential for irreparable harm if Employee Obligations are not paid or otherwise satisfied when due, the Debtors seek authority to pay all such Employee Obligations as they become due, in the ordinary course of business. The Debtors will have sufficient funds to pay all requested amounts as and when due, assuming they are granted authority to use cash collateral.² All payments made on account of the Employee Obligations will be made in accordance with any budget approved by this Court with respect to the use of cash collateral.

² Contemporaneously herewith, the Debtors have sought authority to use cash collateral.

Compensation and Benefits Structure

Payroll and Related Obligations

28. In the ordinary course of business, each of the Debtors outsource each and every one of their Salaried Employees in accordance with the Client Services Agreement dated December 16, 2011 with Resourcing Edge, Inc. ("Resourcing Edge"), a personnel management services company. In effect, the Salaried Employees' wages, salaries, and withholdings (*i.e.*, amounts that employers are required by law to withhold from employee payroll checks with respect to federal, state and local income taxes, social security taxes, and Medicare taxes) are handled through Resourcing Edge. The Contractors are paid pursuant to the terms of their applicable agreement.

Employee Wage Payments

29. The Debtors, through Resourcing Edge, ordinarily pay the Salaried Employees bi-weekly. The standard work week for full-time Employees is 40 hours, with some employees working more or less than the standard number of hours during any given week. Bi-weekly Compensation Obligations for the Debtors are between \$80,000 - \$90,000 per pay period. With few exceptions, payroll is directly deposited into the Salaried Employees' respective bank accounts. Typically, two days before each payday, Resourcing Edge withdraws an amount calculated to cover all Compensation Obligations from the applicable payroll.³ Most recently, the Salaried Employees were paid March 5, 2012. Additionally, the Contractors were paid current through the Petition Date. As such, as of the Petition Date, the Debtors believe no amounts are due to Employees and that they are current on all payroll obligations.

³ The Debtors maintain approximately three weeks of Compensation Obligations on deposit with Resourcing Edge.

Contractor Wage Payments

30. The Debtors have hired 14 Contractors and pay these Contractors directly as vendors. The Contractors submit invoices for their services, which the Debtors pay directly and the Contractors are responsible for their own withholding. Nine Contractors are paid pursuant to consulting agreements and five Contractors are paid bi-weekly in arrears at the end of each month without a written agreement.

Payroll Taxes and Other Withholding Obligations

31. During each pay period, the Debtors, through Resourcing Edge, make a deduction from the Salaried Employees' pay for certain obligations, including, but not limited to, federal and state income taxes, federal and state unemployment and disability taxes, social security and Medicare taxes (collectively, the "Payroll Tax Obligations") and subsequently remit the amount withheld to the appropriate governmental authorities. The Debtors do not have Payroll Tax Obligations for the Contractors as the Contractors are responsible for their own taxes.

32. Additionally, as set forth in more detail below, the Debtors, through Resourcing Edge, make deductions from each Salaried Employee's pay for such employee's contributions with respect to 401(k) plans and similar programs. Typically, Resourcing Edge remits such contributions (the "Benefit Deductions") to such employee benefit plans. As of the Petition Date, the Debtors are current with respect to Payroll Tax Obligations and their Benefit Deductions.⁴

⁴ In the ordinary course of processing payroll checks for their employees, the Debtors may also, from time to time, be required to withhold certain amounts for various garnishments. With this Motion, the Debtors also seek authority to pay any such garnishments, if applicable, on pre-petition amounts owed.

Reimbursement Obligations

33. The Debtors, in the ordinary course of business, reimburse the Employees and Contractors for a variety of expenses incurred in the course of their employment (the “Reimbursement Obligations”). These Reimbursement Obligations include, among other things, business-related travel and business-related expenses. The Debtors typically reimburse the Employees and Contractors for business expenses on an as needed basis via check. The Debtors cannot determine the precise amount of the Reimbursement Obligations at any given time, as Employees and Contractors may have reimbursable expenses that have not been submitted. As such, the Debtors seek authorization to satisfy all Reimbursement Obligations and continue the practice of reimbursing the Employees and Contractors for business expenses incurred in the ordinary course.

Paid Vacation

34. The Debtors offer paid vacation to the Salaried Employees based on the Salaried Employees’ experience and terms, which were individually agreed upon at the time each Employee was hired. Additionally, the Debtors close for business on 10 days throughout the year in recognition of New Year’s, Good Friday, Memorial Day, July 4th, Labor Day, Columbus Day, Thanksgiving, and Christmas.

Credit Cards and Debit Cards

35. The Debtors provide Visa cards and debit cards (collectively, the “Credit Cards”)⁵ to nine Employees, to which such Employee may charge company-related expenses. The Credit Cards help streamline the reimbursement process, as the Debtors can write one check or prepay to cover several different Employees’ reimbursable expenses, rather than having to handle

⁵ There is also one Credit Card for the Accounts Payable Department at Cano.

multiple individual requests. The Debtors seek authority to continue paying the Visa and debit card charges (the “Credit Card Obligations”) made by the Employees in the ordinary course of business.

Other Programs

36. The Debtors seek to pay all pre-petition amounts owed under all of their other Employee Obligations, and continue those programs in the ordinary course of business. The Debtors believe that only *de minimus* outgoing payments are owed or will be incurred, including, but not limited to, any direct deposit programs. The Debtors summarily request that they be authorized, but not directed, to pay any costs or penalty incurred by the Employees in the event a check issued by the Debtors for payment of any of the Employee Obligations or Contract Payments is inadvertently not honored because of the commencement of this Case.

Argument and Authorities

37. Pursuant to Bankruptcy Code § 507(a)(4), employee claims for “wages, salaries, or commissions, including vacation, severance, and sick leave pay” earned within 180 days before the Petition Date are afforded unsecured priority status of \$11,725.00 per employee. Similarly, Bankruptcy Code § 507(a)(5) provides that employee claims for contributions to an employee benefit plan are also afforded priority status to the extent of \$11,725.00 per employee covered by such plan, less any amounts paid pursuant to Bankruptcy Code § 507(a)(4).

38. Furthermore, Bankruptcy Code § 363(b)(1) provides, in pertinent part, that “[t]he trustee, after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . .”⁶ Bankruptcy Code § 105(a) further states that a bankruptcy court may issue any order that will help facilitate the Bankruptcy Code’s purpose:

⁶ 11 U.S.C. § 363(b)(1).

The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.⁷

39. The Debtors believe that most, if not all, of the Employee Obligations relating to the period before the Petition Date constitute unsecured priority claims under Bankruptcy Code §§ 507(a)(4) and (a)(5). As priority claims, the Employee Obligations must be paid in full before any general unsecured claim may be satisfied. Accordingly, the relief requested may affect only the timing of the payment of these primary obligations and will not prejudice the rights of general unsecured creditors or other parties-of-interest.

40. A bankruptcy court's use of its equitable powers "to authorize the payment of pre-petition debt when such payment is needed to facilitate the rehabilitation of the Debtor is not a novel concept."⁸ Numerous bankruptcy courts have relied on Bankruptcy Code § 105(a) to authorize the payment of pre-petition claims of Employees, when, as in this Case, the nonpayment or delay in payment of such pre-petition claims would damage a debtor's business or ability to reorganize.⁹ This authority is sometimes referred to as the "Doctrine of Necessity," or "Necessity of Payment" rule, which functions in a chapter 11 case as a mechanism by which the bankruptcy court can exercise its equitable power to allow payment of critical pre-petition

⁷ 11 U.S.C. § 105(a).

⁸ See *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

⁹ See *id.* at 176 (finding the doctrine is consistent with the paramount goal of chapter 11 to facilitate the "continued operation and rehabilitation of the debtor"); *In re CoServ., L.L.C.*, 273 B.R. 487, 494, n.10 (Bankr. N.D. Tex. 2002) (noting that "wage claims typically are payable out of necessity as well as by virtue of their priority"); *In re Tulsa-Expo Holdings, Inc.*, No. 08-45057, 2008 WL 4857954, at * 11 (Bankr. N.D. Tex. Nov. 7, 2008) (concluding that payment of the pre-petition employee claims "is consistent with the Code and this court's prior decisions."); *Michigan Bureau of Workers' Disability Comp. v. Chateaugay Corp.* (*In re Chateaugay Corp.*), 80 B.R. 279, 287-88 (S.D.N.Y. 1987), *appeal dismissed*, 838 F.2d. 59 (2d Cir. 1988) (debtor authorized to pay certain pre-petition wages, salaries, employee reimbursement expenses, and benefits, including payment of workers' compensation claims).

claims.¹⁰ The Debtors submit that the present circumstances warrant the application of this doctrine or rule.

41. The continued services and cooperation of the Employees are integral and necessary to the Debtors' successful reorganization.¹¹ If the Debtors are unable to assure their Employees that they will be paid timely, or, if Employees are not immediately assured of uninterrupted, critical benefit payments to which they are entitled, the Debtors' operations could suffer immediate and irreparable harm due to employee resentment, resignations, loss of good will and disruption of employee morale.¹² Moreover, replacing Employees who may leave the Debtors' employ if the relief requested herein is not granted would be expensive and disruptive to the Debtors' businesses and their reorganization efforts. Payment of employee wages, vacation pay, sick leave pay, and other accrued benefits in this Case will have little, if any,

¹⁰ See *In re Boston & Maine Corp.*, 634 F.2d 1359, 1382 (1st Cir. 1980) (recognizing the existence of a judicial power to authorize trustees to pay claims for goods and services that are indispensably necessary to the debtor's continue operation).

¹¹ *In re Tulsa-Expo Holdings, Inc.*, No. 08-45057, 2008 WL 4857954, at * 11 (Bankr. N.D. Tex. Nov. 7, 2008) ("A central purpose of chapter 11 is to realize on a debtor's going concern value. That going-concern value is dependent in part upon the continuity and performance of the debtor's work force . . . The continuity and performance of a debtor's work force is, in turn, typically dependent on timely payment of wages and benefits."); *In re CEI Roofing, Inc.*, 315 B.R. 50, 61 (Bankr. N.D. Tex. 2004) ("If employees are not paid, they will leave. If they leave the Debtor's business, the bankruptcy case fails shortly after the filing. No one will benefit from the process."); *In re Equalnet Comm. Corp.*, 258 B.R. 368, 370 (Bankr. S.D. Tex. 2001) ("Employees are more likely to stay in place and to refrain from actions which could be detrimental to the case and/or the estate if their pay and benefits remain intact and uninterrupted."); *In re Gulf Air, Inc.*, 112 B.R. 152, 154 (Bankr. W.D. La. 1989) (authorizing payment of all pre-petition amounts due the debtor's employees because "retention of skills, organization, and reputation for performance must be considered valuable assets contributing to going concern value and aiding rehabilitation where that is possible").

¹² *In re Tulsa-Expo Holdings, Inc.*, No. 08-45057, 2008 WL 4857954, at *3 (Bankr. N.D. Tex. Nov. 7, 2008) (noting that satisfaction of employees' pre-petition claims is essential because, among other things, absent paying these claims there would be significant turnover, which would interrupt the continuity of business and affect employee morale who would be preoccupied with their personal economic issues rather than the employer's reorganization.).

impact on the payment of other creditor's claims. Conversely, the Employees would endure a substantial hardship if they were to lose (or suffer delay in receiving) their pay or benefits.¹³

42. With respect to Payroll Taxes in particular, the payment of such taxes will not prejudice other creditors of the Debtors' estates, as the relevant taxing authorities generally would hold priority claims under Bankruptcy Code § 507(a)(8) in respect to such obligations. Additionally, the failure to make such payments may subject the Debtors and their officers to federal or state liability.¹⁴ Further, under Bankruptcy Code § 541, such funds are not property of the Debtors' estates, and therefore the funds are not subject to the normal bankruptcy prohibition against payment.¹⁵

43. Additionally, the Debtors believe that the continuance of payments of administrative fees to the administrators of the Debtors' Employee Obligations is necessary. Without the continued services of these administrators, including, but not limited to, Resourcing Edge, the Debtors will be unable to continue to honor their Employee Obligations in an efficient and cost-effective manner.

44. The Debtors do not seek to alter their compensation, vacation, or other Benefit Programs at this time. This Motion is intended only to permit the Debtors, in their discretion, to make payments consistent with the Debtors' existing policies to the extent that, without the benefit of an order approving this Motion, such payments may be inconsistent with the relevant provisions of the Bankruptcy Code, and to permit the Debtors, in their discretion, to continue to honor their practices, programs and policies with respect to their Employees, as such practices,

¹³ *Id.*

¹⁴ *See* TEX. TAX CODE ANN. § 111.016.

¹⁵ *See Begier v. IRS*, 496 U.S. 53, 59 (1990) (because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not "property of the estate").

programs, and policies were in effect as of the Petition Date. Payment of all Employee Obligations in accordance with the Debtors' pre-petition business practices is in the best interest of the Debtors' estates, their creditors, and all parties-in-interest and will enable the Debtors to continue their business in an economic and efficient manner without disruption. The Debtors' Employees are central to their operation and vital to this Case. A significant deterioration in employee morale at this critical time undoubtedly would have a devastating impact on the Debtors, their customers and vendors, the value of the Debtors' assets and business, and the Debtors' ability to continue operations. The total amount sought to be paid herein is relatively modest compared with the size of the Debtors' overall business and the importance of the Employees to this Case.

45. To the extent Employees are owed in excess of \$11,725.00, payment of compensation, benefit and reimbursement in such higher amount is justified in this Case. If such Employees are not paid, the Debtors will lose the services of such Employees and the Debtors' ability to reorganize will be jeopardized. Claims that are over \$11,725.00 have arisen in the ordinary course of business and are reasonable in relation to the services rendered. Most likely, any such claims over \$11,725.00 constitute compensation for those Employees providing highly skilled services during the course of their employment. As such, the Debtors need to retain these Employees to have a meaningful chance of successfully reorganizing.

46. Moreover, the relief requested will significantly reduce the administrative burden that otherwise might occur in this Case. Requiring the Debtors to identify whether and to what extent individual Employees hold priority or general unsecured claims for employee benefits, and to modify benefit policies to enforce these distinctions, would impose additional burdens of administration and expenses, which seem unwarranted under the circumstances of this Case.

The Debtors would have to spend additional time and incur additional expense if they were required to segregate the priority portion of an employee's wage and benefit claims from the general unsecured portion, and then to provide different treatment for each of the Employees. Further, the Employees arguably may be entitled to assert an administrative priority claim for all wages and benefits, so long as such Employees continue to perform services for the Debtors.

47. The Debtors do not intend by this Motion to assume any executory contracts or unexpired leases, and this Motion should not be considered as an assumption or adoption of any pre-petition employment agreements or policies.¹⁶ Rather, the Debtors simply intend, in their discretion and in the exercise of their business judgment, to maintain current staff and policies consistent with prior employment and policies pending confirmation of the Plan.

Honoring Checks and Electronic Transfers

48. The Debtors request that all Disbursement Banks be directed to receive, process, honor and pay all checks presented for payment and to honor all funds transfer requests made by the Debtors relating to the Employee Obligations, whether such checks were presented or fund transfer requests were submitted before or after the Petition Date. Further, the Debtors request authority to issue post-petition checks, or to effect post-petition fund transfers to replace any checks or fund transfer requests dishonored or denied as a consequence of the commencement of this Case.

Request for Immediate Relief

49. Bankruptcy Rule 6003 provides that, to the extent "relief is necessary to avoid immediate and irreparable harm," a bankruptcy court may approve a request to "pay all or part of

¹⁶ The Debtors are currently reviewing this matter and reserves their rights with respect to future cessation or continuation of these programs and assumption or rejection of any executory contracts.

a claim that arose before the filing of the petition,” before 21 days after the Petition Date.¹⁷ For the reasons stated previously herein, the Debtors submit that the relief requested is absolutely necessary to prevent immediate and irreparable harm to these estates. Furthermore, to successfully implement the relief requested herein, the Debtors request a waiver of the notice requirements of Bankruptcy Rule 6004(a) and the 14-day stay under Bankruptcy Rule 6004(h).

Conclusion

50. The Debtors seek authority to pay the accrued and unpaid pre-petition Employee Obligations described above, and to continue, post-petition, the Benefit Programs in effect on the Petition Date, in their business judgment and in the ordinary course of business. The relief requested is in the best interest of the Debtors’ estates and their creditors because they will preclude hardship to the Employees and maintain the viability of the Debtors’ business, which is crucial to the Debtors’ reorganization efforts.

Notice

51. Notice of this Motion has been provided to (a) Union Bank N.A., (b) Natixis Financial Products, Inc.; (c) UnionBanCal Equities, Inc; (d) the Debtors’ 30 consolidated largest unsecured creditors; (e) NBI Services, Inc.; (f) the Office of the United States Trustee for the Northern District of Texas, (g) the Office of the United States Attorney for the Northern District of Texas, (h) the Securities and Exchange Commission; (i) the Internal Revenue Service, (j) the Railroad Commission of Texas, (k) State of New Mexico Energy Minerals, and (l) Oklahoma Corporation Commission. The Debtors submit that in view of the facts and circumstances that the notice provided for herein is fair and adequate and no other or further notice is necessary.

¹⁷ Fed. R. Bankr. P. 6003.

PRAYER

WHEREFORE the Debtors respectfully request that the Court enters an order (a) authorizing the Debtors to (i) pay any and all of the pre-petition Compensation Obligations; (ii) honor any and all of the Debtors' Pre-Petition Employee Benefit Obligations; and (iii) continue paying the Employee Obligations and administering the Employee Benefit Programs in the ordinary course of business; and (b) directing all banks to receive, process, honor, and pay any and all checks, electronic fund transfers, and automatic payroll transfers drawn on the Debtors' Disbursement Accounts to the extent that such checks or transfers relate to any of the Employee Obligations. The Debtors further request that this Court grants them such other and further relief as this Court may deem just and proper, both at law and equity.

DATED: March 8, 2012.

Respectfully submitted,

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/s/ Demetra Liggins

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**PROPOSED COUNSEL FOR DEBTORS
AND DEBTORS-IN-POSSESSION**

Salaried Employees

Company	Full Name	Job Function
Cano Petroleum, Inc.	Valerie Durazo	Administrative Assisntant
Cano Petroleum, Inc.	Jayme Wollison	Director
Ladder Companies, Inc.	Susan Hayden	Assistnat
Ladder Companies, Inc.	Justin Hesslin	Operator
Ladder Companies, Inc.	Michael Parrish, Sr.	Operations Manager
Ladder Companies, Inc.	Louis Parrish	Operator
Cano Petro of New Mexico, Inc	Rodger Butts	Foreman
Cano Petro of New Mexico, Inc	Jeremy Calkins	Operator
Cano Petro of New Mexico, Inc	David Ramirez	Foreman
Cano Petro of New Mexico, Inc	Kevin Scitern	Operator
Square One Energy, Inc	Landreth Hornbeck	Manager
W.O. Operating Company, Ltd	Tommy Hefner	Production Superintendent
W.O. Operating Company, Ltd	John Allen	Production Manager
W.O. Operating Company, Ltd	Andrea McDowell	Office Manager
W.O. Operating Company, Ltd	Shawn Smith	Supervisor
W.O. Operating Company, Ltd	William Smith	Supervisor
W.O. Operating Company, Ltd	Ricky Nickell	Pumper
W.O. Operating Company, Ltd	Gerald Anderson	Pumper
W.O. Operating Company, Ltd	Manuel Miramontes	Pumper
W.O. Operating Company, Ltd	Homer Tice	Pumper
W.O. Operating Company, Ltd	Mark Tooley	Pumper
W.O. Operating Company, Ltd	Julius Ketchersid	Pumper
W.O. Operating Company, Ltd	David Harvill	Pumper
W.O. Operating Company, Ltd	Manuel L. Miramontes	Pumper

W.O. Operating Company, Ltd	Robert Lewis	Lease Operator
W.O. Operating Company, Ltd	Brenda Glassey	Administrative Assistant
W.O. Operating Company, Ltd	Robert Passmore	Director of Marketing

Contractors

Company	Full Name	Job Function
Cano Petroleum, Inc.	James Latimer, III	Chief Executive Officer
Cano Petroleum, Inc.	John Homier	Chief Financial Officer
Cano Petroleum, Inc.	Adrian Lamberti	Controller
Cano Petroleum, Inc.	Jayson Potts	Senior Accountant
Cano Petroleum, Inc.	Eric Hyman	Engineer
Cano Petroleum, Inc.	Tina Sanford	Revenue Accountant
Cano Petroleum, Inc.	Yolanda Bostick	Senior Accountant
Cano Petroleum, Inc.	Sandra Durazo	Legal Assistant
Cano Petroleum, Inc.	Kathy Boswell	Revenue Accountant
Ladder Companies, Inc.	Steven Parrish	Field Worker
Ladder Companies, Inc.	Jerry Anderson	Field Worker
Ladder Companies, Inc.	David Witty	Field Worker
Ladder Companies, Inc.	Duane Mathis	Field Worker
Cano Petro of New Mexico, Inc.	Jesus Omar Castanon	Field Worker

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

IN RE	§	
	§	CASE No. _____
CANO PETROLEUM, INC., ET AL.	§	JOINTLY ADMINISTERED
	§	
Debtors.	§	(CHAPTER 11)

**ORDER AUTHORIZING THE DEBTORS (A) TO PAY PREPETITION
WAGES, SALARIES AND PAYROLL TAXES, (B) TO REIMBURSE EMPLOYEES
FOR PREPETITION BUSINESS EXPENSES, AND
(C) TO HONOR EXISTING BENEFIT PLANS AND POLICIES
AT THEIR DISCRETION IN THE ORDINARY COURSE OF BUSINESS**

Having considered the Debtors' *Emergency Motion to (A) Approve Pre-Petition Wages, Salaries and Payroll Taxes; (B) to Reimburse Employees for Pre-Petition Business Expenses; and (C) to Honor Existing Benefit Plans and Policies at Their Discretion in the*

Ordinary Course of Business (the “Motion”)¹; *the Declaration of James R. Latimer, III in Support of Voluntary Petitions, First-Day Motions and Designation as Complex Bankruptcy Case*; and the evidence and arguments presented at the hearing, the Court finds that: (a) jurisdiction over the matters in the Motion is proper pursuant to 28 U.S.C. §§ 1334 and 157; (b) venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409; (c) proper and adequate notice of the Motion is provided and no further notice is needed; (d) the relief sought in the Motion is in the best interest of the Debtors’ estates, their creditors and all parties-in-interest; and (e) good and sufficient cause exists for granting the relief requested in the Motion. Accordingly, it is

ORDERED that the Motion hereby is **GRANTED**. It is further

ORDERED that the Debtors are authorized, but not directed, to continue to administer all of the Employee Obligations in the ordinary course of business, at their discretion. It is further

ORDERED that the Debtors are authorized, but not directed, to pay all Compensation Obligations and Credit Card Obligations, in the ordinary course of business pursuant to and in accordance with the budget for the use of cash collateral approved by this Court. It is further

ORDERED that the Debtors are authorized, but not directed, to honor and continue the Benefit Obligations and Benefit Programs, in the ordinary course of business, at their discretion. It is further

¹ All capitalized terms not defined herein shall have the meaning ascribed to them in the Motion.

ORDERED that all payments made by the Debtors in connection with the Compensation Obligations, Reimbursement Obligations, Payroll Tax Obligations, Benefit Deductions, and/or Credit Card Obligations hereby are **APPROVED** and ratified. It is further

ORDERED that the banks on which checks are drawn or electronic payment requests are made are authorized (a) to receive, process, honor, and pay all checks presented for payment and related to the Employee Obligations provided that sufficient funds are available in the Debtors' bank accounts to cover such payments; and (b) to rely on the representations of the Debtors as to which checks are permitted to be paid pursuant to this Order. It is further

ORDERED that the Debtors hereby are authorized, but not directed, to issue post-petition checks, to effect the post-petition funds transfer requests in replacement of any checks or fund transfer requests with respect to their Employee Obligations dishonored or denied as a consequence of the commencement of this Case. It is further

ORDERED that the Debtors are authorized, but not directed, to pay any costs or penalty incurred by any employee in the event that a check issued by the Debtors for payment of an Employee Obligation is inadvertently not honored because of the filing of this Case. It is further

ORDERED that nothing in this order or the Motion shall be construed as prejudicing any rights the Debtors may have to dispute or contest the amount, or the basis for any claims against the Debtors in connection with or related to the claims addressed by this Order. It is further

ORDERED that, notwithstanding Bankruptcy Rule 6004(h), the terms and conditions of this Order shall be effective immediately and enforceable upon its entry. It is further

ORDERED that the Debtors, their officers, employees, and agents, are authorized to take or refrain from taking such acts as are necessary and appropriate to implement and effectuate the relief requested herein. It is further

ORDERED that this Court shall retain jurisdiction over all matters arising from or related to the interpretation and implementation of this Order.

###END OF ORDER###