UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	:	Case No. 08-62733
	:	Chapter 11 – Jointly Administered
Triad Resources, Inc., *et al.*,[1]	:	Judge C. Kathryn Preston
	:	
Debtors.	:	**Date of Hearing: May 20, 2009, 9:30 A.M.**
		Last Day to Object: May 7, 2009

OBJECTION OF DEBTORS AND DEBTORS-IN-POSSESSION TO AMENDED MOTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS PURSUANT TO SECTION 1112 OF THE BANKRUPTCY CODE TO DISMISS CASES OR, IN THE ALTERNATIVE, TO CONVERT CASES TO PROCEEDINGS UNDER CHAPTER 7 OF THE BANKRUPTCY CODE

Triad Resources, Inc. ("Resources"), Triad Energy Corporation ("TEC"), TriTex Energy, L.L.C. ("TTE"), TriTex Resources, L.L.C. ("TTR), Triad Oil & Gas Co., Ltd. ("TOG" and, together with Resources, TEC, TTE, and TTR, the "Triad Debtors"), and Alpha Drilling, Ltd. ("Alpha" and, together with the Triad Debtors, the "Debtors"), by and through their undersigned counsel of record, hereby object (the "Objection") to the April 15, 2009, *Amended Motion of Official Committee of Unsecured Creditors Pursuant to Section 1112 of the Bankruptcy Code to Dismiss Cases or, in the Alternative, to Convert Cases to Proceedings Under Chapter 7 of the Bankruptcy Code* [Docket No. 284] (the "Motion") filed by the Official Committee of Unsecured Creditors (the "Committee"). In support of this Objection, Debtors respectfully state:

PRELIMINARY STATEMENT

1. The Motion should be denied because it is entirely without merit, legally or factually. Debtors are not operating at a loss. Assuming arguendo that, including depletion,

[1] The "Debtors" in the instant cases include each of Triad Resources, Inc. (Case No.08-62733, "TRI"); Triad Energy Corporation, (Case No. 08-62744, "TEC"); TriTex Energy, L.L.C. (Case No. 08-62747, "TEL"); TriTex Resources, L.L.C., Case No. 08-62749, "TRL"); Triad Oil & Gas Co., Ltd. (Case No. 08-62757, "TOG"); and Alpha Drilling, Ltd. (Case No. 08-62759, "ADL").

depreciation, amortization, postpetition interest and chapter 11 professional fees, Debtors' profit and loss statement may show a loss for a period during chapter 11, Debtors present a reasonable likelihood of rehabilitation. Debtors' cases, therefore, should not be converted or dismissed.

BACKGROUND

2. On December 31, 2008, Debtors each filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code").[2] Pursuant to Sections 1107 and 1108, Debtors continue to operate their businesses and manage their properties as debtors-in-possession. No trustee or examiner has been appointed in the Debtors' bankruptcy cases (the "Chapter 11 Cases").

3. On January 14, 2009, the Office of the United States Trustee for Region IX appointed the Committee.

Debtors' Operations in Chapter 11

4. At Debtors' request, with the concurrence of Capital One, N.A. and the Committee, the Court has entered a series of orders, including final orders entered on January 9, 2009 [Docket No. 56] (the "Alpha Cash Collateral Order"); on February 13, 2009 [Docket No. 178] (the "Triad Cash Collateral Order"); and on February 27, 2009 [Docket No. 216] (the "Capital One Financing Order"), that authorize Debtors to use cash collateral, while adequately protecting approximately $70 million in prepetition secured debt held by Capital One, and authorize the Triad Debtors to obtain post-petition debtor-in-possession financing with Capital One. Alpha is in the process of negotiating a similar post-petition facility with its senior secured lender, Wesbanco Bank, Inc.

5. In the four months since filings their chapter 11 petitions, Debtors have stabilized their business and operations in chapter 11, retained their customer base, slowly earned trade

credit from many important suppliers, surgically reduced staff while retaining key employees, dramatically reduced their expenses, efficiently managed their businesses and thereby consistently produced financial results exceeding their financial projections.

6. Debtors are current on post-petition obligations, including the payment of taxes, interest, administrative expenses, and adequate protection payments; and, subject to concluding negotiations with Wesbanco, otherwise are fully compliant with their obligations as debtors-in-possession.

7. With the concurrence of Capital One and the Committee, Debtors are actively marketing their assets and businesses for sale as a going concern. The "packages" of these assets which Debtors are marketing are:

- ***Package A*** – Wells, acreage, and service equipment in West Virginia associated with the Marcellus Package in the Data Room Presentation
- ***Package B*** – Wells, acreage, and service equipment in West Virginia associated with the Enhanced Oil Recovery Package in the Data Room Presentation
- ***Package C*** – Wells, acreage, and service equipment in Ohio and West Virginia associated with the Conventional Ohio and West Virginia Package in the Data Room Presentation
- ***Package D*** – Wells, acreage, and service equipment in Kentucky associated with the Kentucky Development Package in the Data Room Presentation
- ***Package E*** – Wells, acreage, and service equipment in Texas and New Mexico associated with the Texas and New Mexico Package in the Data Room Presentation
- ***Package F*** – Pipelines and Rights-of-Way in Ohio and West Virginia associated with the Eureka Pipeline Package in the Data Room Presentation
- ***Package G*** – Disposal Well and related equipment owned by Resources
- ***Package H*** – Drilling rigs and equipment owned by Alpha

[2] Unless otherwise stated herein, all "Section" references are to the Bankruptcy Code.

The marketing efforts of Debtors' investments bankers, RBC Capital Markets Corporation and Barrier Advisors, Inc., has led to contacts with over 200 prospective bidders; the execution of over 40 confidentiality agreements; and on-site data room visits, involving detailed management discussions and diligence by seven highly qualified prospective bidders (to date). These efforts are active and ongoing.

8. At Debtors' request, with the concurrence of Capital One and the Committee, the Court extended Debtors' exclusive periods for filing, and soliciting acceptances of, a chapter 11 plan, with no plan filing required until the anticipated conclusion of the bid process, *i.e.*, June 30, 2009.

Debtors' Exit Strategy for their Chapter 11 Cases

9. Debtors believe that they will obtain fair bids for the purchase of their assets and businesses as a going concern. Debtors expect that as they weigh the forthcoming bids Debtors will determine, in the proper exercise of Debtors' business judgment, what resolution of these chapter 11 cases is in the best interest of Debtors, their creditors and their estates.

10. For example, and among other options available to Debtors, Debtors may determine that the best course of action for them and their estates are—

(a) selling all, or substantially all, of their assets and businesses as a going concern pursuant to Section 363, prior to confirming a chapter 11 plan;

(b) selling all, or substantially all, of their assets and businesses as a going concern, pursuant to a chapter 11 plan;

(c) confirming a chapter 11 plan implementing a restructuring of Debtors;

(d) confirming a chapter 11 plan refinancing Debtors' senior secured debt and other obligations to creditors; or

(e) combining a sale of certain substantial assets and businesses of Debtors as a going concern and the restructuring and refinancing of Debtors' businesses pursuant to a chapter 11 plan.

Debtors' "Unencumbered Assets"

11. In their prepetition agreements, Debtors and Capital One generally intended that substantially all of the assets of the Triad Debtors were to be subject to mortgages, deeds of trust, security interests and other voluntary liens in favor of Capital One. Notwithstanding this intent, as Debtors have informed Capital One and the Committee, certain of the Triad Debtors' assets appear to be subject to no such liens in favor of Capital One, which include such assets as certain surface rights, a certain field of several dozen oil and gas wells and certain pipeline rights of way (together, the "Unencumbered Assets").[3] The Unencumbered Assets are valuable (certainly more than $1 million in the aggregate, in Debtors' view), but are presently difficult to value precisely. Among other constraints, there do not appear to be recent stand-alone transactions that would reflect with reasonably accuracy the current market for these assets.

12. Debtors understand that the Committee is aggressively seeking to protect their perceived interests in the Unencumbered Assets by trying to negotiate with Capital One a "deal" that would protect the risks to unsecured creditors in the event that the value of the Unencumbered Assets (a) were later to be determined to be "less" than may be perceived today, or (b) were to decline in value compared to their perceived value today. Debtors further understand that although Capital One and the Committee have engaged in settlement discussions, they have not reached a "deal" as of the filing of this Objection.

[3] By the use of the term "Unencumbered Assets" Debtors make no admission about whether these or any other assets are or are not encumbered by liens in favor of Capital One or any other party.

13. The Motion was filed by the Committee in an attempt to place maximum pressure on Debtors, and Capital One, to achieve a "deal." Such "high risk/high reward" strategies have their place, but this Motion has no merit whatsoever.

Debtors Are Not Generating Losses and Are Viable Candidates for Rehabilitation

14. The Motion is rife with misrepresentations, half-truths and outright falsehoods. Among these are the following:

A. "*…Debtors have operated at a loss…*" (Motion, ¶ 5.) In fact, the Triad Debtors' operations have generated positive cash flow of $569,118 through February 28, 2009, and the Debtors' operations (including Alpha) have generated positive cash flow of $530,996 through February 28, 2009.

B. "*…Debtors will continue to operate at a loss…*" (Motion, ¶ 5.) In fact, as demonstrated in Debtors' cash variance report for weeks 5 through 16, Debtors have generated $1,058,101 in positive cash flow, consistently beating its projections. While Debtors intend and expect to beat their projections going forward, even if Debtors' performance exactly mirrored their projections the Debtors would have achieved positive cash flow through June 30, 2009.

C. "*By their own admission, Debtors do not intend to reorganize in the traditional sense…*" (Motion, ¶ 8.) Debtors never have made such a statement. In fact, Debtors may reorganize, but only after testing the market for the sale of their assets.

D. "*The Debtors have acknowledged that under no circumstances are they likely "to shift their focus from the marketing and sale of assets to a meaningful Plan process*." (Motion, ¶ 8.) *See* response to item C. above.

E. "*Debtors spent nearly nine percent more than their revenue in February…*" (Motion, ¶ 10.) In fact, not including "Depreciation, Depletion and Amortization" (a non-cash item), Debtors' February expenditures ($1,751,418) were over 7% less than Debtors' February revenues ($1,885,123).

F. "*On a cash flow basis, over the next ten weeks, Debtors will average negative cash flow of more than $30,000 per week.*" (Motion, ¶ 10.) *See* response to item B. above.

G. "*The Debtors' use of the DIP Financing proceeds single-handedly refutes any argument that the DIP Financing is adding value to the estate commensurate with the assets it is eroding.*" (Motion, ¶ 11.) There is no factual basis whatsoever for this assertion. Indeed, without the DIP Financing and the protection of chapter 11, Debtors' operations could not continue, the value of all of its assets would be

jeopardized and the prospect of a going concern sale or reorganization would be lost.

H. "*…Debtors have no ability or intent to obtain confirmation of a true reorganization plan*." (Motion, ¶ 14.) *See* response to item C. above.

I. "*Here, by their own admission, Debtors do not plan to propose a traditional plan of reorganization*." (Motion, ¶ 15.) *See* response to item C. above.

J. "*While the Debtors are pursuing their speculative attempt to find a buyer, they are rapidly eroding the assets that could be sold to pay their unsecured creditors*." (Motion, ¶ 17.) *See* response to item G. above.

K. "*This erosion is assuring that there will be no funds available to pay unsecured creditors if the Debtors fail to sell the businesses as going concerns.*" (Motion, ¶ 17.) *See* response to item G. above.

L. "*Dismissal, on the other hand, would allow the debtors to keep operating…*" (Motion, ¶ 18.) *See* response to item G. above.

15. The Motion confuses physical depletion with loss of value. The ongoing depletion of oil and gas assets in the course of production may be a fact of physical science, but the asserted erosion of asset value is an utter fabrication. The depletion of these assets is not eroding value. The depletion of these assets generates revenues, which are in excess of the costs of operations, which generates positive cash flow, which generates value.

16. Without the DIP Financing and the protection of chapter 11 of which the Motion complains, Debtors' ability to produce revenues in chapter 11 would be threatened. Debtors' continued operations, with the support of the DIP Financing and the protections of chapter 11, preserve and enhance value for creditors.

17. Debtors' chapter 11 business model is designed to preserve and enhance, and has preserved and enhanced, going-concern value and the prospect of a "reorganization" or a "rehabilitation" of Debtors' various business segments—should this result be in the best interests of Debtors and their estates.

18. Debtors are sympathetic to the Committee's efforts to obtain fair value for the Unencumbered Assets for the benefit of their constituents, the unsecured creditors. Debtors have offered, and continue to be willing, to provide both the Committee and Capital One with information that may facilitate the resolution of these matters.

19. Debtors cannot, however, permit the present issues pertaining to the Unencumbered Assets to justify conversion or dismissal of the Chapter 11 Cases. Nor can Debtors permit the present issues pertaining to the Unencumbered Assets to take precedence over the marketing of Debtors' assets now in process. These marketing efforts are of paramount importance to all parties in the Chapter 11 Cases.

LAW AND ARGUMENT

20. The Motion is brought under Section 1112(b), which provides, in pertinent part:

> "[A]bsent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.
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> * * *
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> [T]he term "cause" includes . . . substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation[.]

11 U.S.C. § 1112(b)(1)&(4)(A).

21. Determinations of whether to convert or dismiss cases are made on a case-by-case basis. *In re Adbrite Corp.*, 290 B.R. 209, 218 (Bankr. S.D.N.Y. 2003) (citing, *inter alia*, *Laguna Assocs. Ltd. P'ship v. Aetna Cas. & Sur. Co. (In re Laguna Assocs. Ltd. P'ship)*, 30 F.3d 734, 737 (6th Cir. 1994)). The Committee bears the burden of establishing cause for conversion or dismissal by a preponderance of the evidence. *Id.* (citing *In re Woodbrook Assocs.*, 19 F.3d 312,

316 (7th Cir. 1994). The Committee must present "such evidence as, when considered and compared with that opposed to it, has more convincing force and produces in [the Court's] mind[] belief that what is sought to be proved is more likely true than not true." *Williams v. Eau Claire Pub. Sch.*, 397 F.3d 441, 444 & 446 (6th Cir. 2005). Thus, "[i]f, on any issue in this case, the evidence is equally balanced, [the Court] cannot find that the issue has been proved by a preponderance of the evidence." *Id.* at 444.

The Committee Has Not Demonstrated Substantial or Continuing Loss or Diminution

22. "To determine whether there is a continuing loss to or diminution of the estate, a court must make a full evaluation of the present condition of the estate, not merely look at the debtor's financial statements." *Adbrite*, 290 B.R. at 215 (citing *In re Moore Const., Inc.*, 206 B.R. 436, 437-38 (Bankr. N.D. Tex. 1997)). "A continuing loss or diminution of the estate may be tolerated where reorganization is feasible and the pattern of unprofitable operations can be reversed as a result of a successful reorganization. The courts must evaluate losses on a case-by-case basis. Small losses over an extended period may be acceptable, whereas large losses in a short period may indicate that rehabilitation is not likely." *Id.* (citing *In re Photo Promotion Assocs.*, 47 B.R. 454, 458-59 (S.D.N.Y. 1985)). Debtors are not experiencing "substantial" or "continuing" losses.

23. Debtors are generating positive operating cash flow, and positive EBIDTA. Any losses Debtors may be experiencing in chapter 11 do not indicate a loss upon emergence. Even if they did, the fact that Debtors are viable candidates for rehabilitation precludes dismissal.

The Committee Cannot Demonstrate an Absence of a Reasonable Likelihood of Rehabilitation and Any Such Determination is Impossible Until After the Sale Process is Explored

24. In order to convert or dismiss a case pursuant to Section 1112(b), "the debtor's financial condition must be such as to permit a determination that there is no reasonable

likelihood that the debtor will be rehabilitated." *In re Cardinal Congregate I*, 113 B.R. 371, 374 (Bankr. S.D. Ohio 1990) (declining to dismiss chapter 11 case due to movant's failure to demonstrate absence of reasonable likelihood of rehabilitation and stating further that "[d]ismissal would be particularly inappropriate where. . . the [d]ebtor has shown a likelihood that its revenues will increase over the next few months . . . ."). "At the early stages of the case, to prove an absence of a reasonable likelihood of rehabilitation, the movant must show that there is no more than a '*hopeless and unrealistic prospect*' of rehabilitiation." *Adbrite Corp.*, 290 B.R. at 215 (quoting *In re Economy Cab & Tool. Co., Inc.*, 44 B.R. 721, 724 (Bankr. D. Minn. 1984)) (emphasis added). Rehabilitation "implies establishing a cash flow from which its current obligations can be met." *Id.* at 216 (citing *In re Rundlett*, 136 B.R. 376, 380 (Bankr. S.D.N.Y. 1992)). "The occurrence of short-term, postpetition losses is not grounds to convert or dismiss a bankruptcy case where financial viability is reasonably likely in the near future." *Id.* at 216 (citing *In re Garland Corp.*, 6 B.R. 456, 460 (1st Cir. B.A.P. 1980)). Further the fact that a debtor is liquidating pursuant to chapter 11 alone does not warrant conversion or dismissal. *See United States Trustee v. GPA Tech. Consults., Inc. (In re GPA Tech. Consults., Inc.)*, 106 B.R. 139, 142-43 (Bankr. S.D. Ohio 1989) (declining to dismiss chapter 11 bankruptcy even where debtor likely would pursue liquidating plan because efficiencies of liquidation and enhanced recovery rights in chapter 11 were paramount).

25. The Committee suggests that because Debtors intend to pursue a going-concern sale of substantially all their assets, there necessarily is no reasonable likelihood of rehabilitation, citing statements made in connection with Debtors' motion to extend plan exclusivity. (Mot., ¶¶ 15-16.) The Committee's sound-bite editing ignores the fact that Debtors' marketing process

includes mechanisms promoting, and in no way foreclosing, rehabilitation of one or more Debtors.

26. In order to maximize value, Debtors are offering eight distinct "bundles" of assets that potential buyers may bid upon collectively, individually, or in combination as they see fit. It is *impossible* for any party in interest to determine presently what assets will be purchased and what assets will be left for potential rehabilitation. Beyond that, Debtors also are soliciting plan sponsorship(s) from bidders, further indicating Debtors' continued effort to pursue all reasonable exit strategies—*including rehabilitation*. The Committee, by virtue of its participation in any number of conference calls with Debtors' investment bankers, is well aware of Debtors' thoughtful and nuanced strategy preserving the option for—and indeed inviting—a rehabilitated end.

27. A reasonable likelihood of rehabilitation is evident. Debtors are current on post-petition obligations, including the payment of taxes, interest, administrative expenses, and adequate protection payments; are maintaining ongoing, revenue-generating business operations; are employing all reasonable measures to minimize operating costs; and, subject to concluding negotiations with Wesbanco, otherwise are fully compliant with their obligations as debtors-in-possession.

28. Furthermore, Debtors' circumstances differ *vastly* from the circumstances warranting conversion or dismissal in the cases relied upon by the Committee. *See, e.g., In re Citi-Toledo Partners*, 170 B.R. 602, 607 (Bankr. N.D. Ohio 1994) (no reasonable likelihood of rehabilitation where the debtor had no employees, no operating income to pay expenses including accumulating real estate taxes, demonstrated no ability to finance a critical project, and let tax credits associated with the project expire); *Angelina v. Cormier (In re Cormier)*, 75 B.R.

692, 693-94 (Bankr. D. Mont. 1987) (no reasonable likelihood of rehabilitation where the debtor failed for 13 months to effectuate a plan of reorganization and continued to incur losses even after failing pay any creditors pending a decision on plan); *Loop Corp. v. United States Trustee*, 379 F.3d 511, 513 & 519 (8th Cir. 2004), *cert. denied*, 543 U.S. 1055 (2005) (no reasonable likelihood of rehabilitation where debtors already liquidated substantially all of their assets at the time motion to convert or dismiss was filed and where only remaining items of value were cash, causes of action, and net operating losses). Other courts have required similarly dire circumstances before finding no reasonable likelihood of rehabilitation. *See, e.g., ABEPP Acquisition Corp. dba Abbott & Co.*, 191 B.R. 365, 368 (Bankr. N.D. Ohio 1996) (no reasonable likelihood of rehabilitation where debtor ceased all operations, had only five employees charged only with liquidating assets, and made various post-petition payments without prior court approval); *In re Cont'l Holdings, Inc.*, 170 B.R. 919, 931 (Bankr. N.D. Ohio 1994) (no reasonable likelihood of rehabilitation where debtor could not demonstrate that it would realize any income from any source).

CONCLUSION

29. The Motion is merely an aggressive attempt to strong-arm a "deal" out of Capital One, and does not reflect the reality of these Chapter 11 Cases. The Committee failed to satisfy *its burden* of proving substantial or continuing loss to or diminution of the Debtors' estate, and the absence of a reasonable likelihood of rehabilitation. The Motion, therefore, should be denied.

WHEREFORE, Debtors respectfully request the entry of an order (a) sustaining this Objection and denying the Motion in its entirety; and (b) granting Debtors such other and further relief to which they are justly entitled.

Dated: April 30, 2009

Respectfully submitted by:

/s/ Daniel A. DeMarco

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Counsel for Debtors and Debtors-in-Possession

CERTIFICATE OF SERVICE

The undersigned certifies that the following is a list of **parties** who are currently on the list to receive e-mail notice/service for this case and who were served by the Court's electronic noticing system on this 30th day of April 2009:

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BMC Group, Inc., the Debtors claims and noticing agent, is, at the direction of the Debtors' undersigned counsel, serving the instant document on the on the parties set forth on the attached Service Lists on this 30th day of April 2009 (the "BMC Service"). An affidavit detailing the BMC Service will be filed with the Court.

/s/ Daniel A. DeMarco
One of the Attorneys for Debtors

SERVICES LISTS FOLLOW

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Service List

Total number of parties: 24

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Total number of parties: 26

2002 List

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