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Chapter 11 bankruptcy is an option for energy companies to survive industry downturns.

Restructuring Options: What to Do When Downturns Strike

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February 04, 2026

As distressed energy companies evaluate their path forward, corporate restructuring may be among the strategies they consider to navigate uncertain and unfavorable economic climates.

In many cases, corporate restructuring—specifically Chapter 11 bankruptcies—have enabled distressed energy players to resolve financial, legal and operational challenges to weather the storm and emerge as leaner and more profitable enterprises.

Corporate restructuring as a strategic alternative

Historically, corporate restructuring provided a strategic

alternative for distressed energy companies to resolve their balance sheet and operational issues. In the two most recent commodity price downturns (2014-2015 and the COVID era), bankruptcy filings in the upstream, midstream and oilfield services sectors hit record levels.

While it's hard to predict when another bust cycle will occur, companies and professionals can learn from the mistakes of the past and be prepared to implement corporate restructuring to strategically revitalize their company's finances.

A few strategic restructuring alternatives can be deployed to save what otherwise may be a sinking ship. More and more, companies are utilizing other out-of-court strategies, such as

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liability-management exercises (LMEs) or middle-market deals, as a means of right-sizing their balance sheets. Such strategies often involve small- to mid-size transactions that focus on reducing liabilities, augmenting liquidity and restructuring debt.

Of course, bankruptcy remains a viable strategic option to achieve financial health and rehabilitation for certain companies, particularly for those with significant liabilities.

Through bankruptcy, distressed companies can mitigate or eliminate liabilities, renegotiate or reject contracts that are overpriced relative to current marketing conditions or otherwise burdensome to ongoing operations, and “right-size” their balance sheets through targeted asset sales that allow companies to focus on core basins or business lines and streamline general and administrative costs.

For example, distressed upstream operators with significant liabilities related to plugging and abandoning wells can utilize a Chapter 11 bankruptcy to manage and dispense with litigation claims that may otherwise be filed outside of the bankruptcy process. We saw this when Cox Operating, one of the largest privately held oil and gas companies operating in the Gulf of Mexico, entered bankruptcy in 2023 and, in so doing, was able to close multiple Section 363 discrete asset sales, mitigate decommissioning liabilities and monetize a large, pre-filing litigation claim.

Considerations for distressed energy companies

Corporate restructurings are often long, expensive and met with challenges, and energy companies that are at risk of insolvency should evaluate a range of factors to help inform and guide their decision as to whether corporate restructuring is the right path forward:

Know the warning signs: As distress may be working its way through the energy sector, it is important for companies to understand the warning signs that they may be entering the “zone of insolvency.” While there is no precise definition for when a company enters the zone of insolvency, common indicators often include the inability to pay debts as they mature; the balance of liabilities exceeds the value of assets; a lack of liquidity; and transactions that leave the company with relatively small capital. Critically, directors and officers during a state of insolvency have expanded fiduciary duties to the company’s equity holders and creditors. When a company faces enough financial distress that insolvency is possible, it is safe to assume that the company has entered the zone of insolvency.

- **Develop a preliminary action plan:** Companies finding themselves in distress or operating in the zone of insolvency should take the appropriate actions to be positioned as

favorably as possible throughout the process. This may require management to take a long, hard look in the mirror and may include tactics such as managing cash flow and liquidity on a daily basis, cutting costs, furloughing nonessential personnel, ensuring payroll obligations are met, staying on top of liens on company assets, and if appropriate, putting liens on third-party assets if they are also potentially at risk for default. Consider making financially responsible changes within your organization’s policies, such as cutting discretionary spending or reducing expenses, and conducting a thorough review of the company’s financial books to ensure that it is complete and organized.

- **Enlist the support of experienced professionals and service providers:** Corporate restructuring is a complex process requiring significant legal, financial and administrative expertise to run smoothly. Law firms and financial restructuring firms are critical to helping companies navigate the turnaround options best suited for their companies. Claims and noticing agents can take on certain administrative burdens, allowing legal and financial professionals to focus on the substantive aspects of the case. When solvency issues are on the line, time is of the essence, and by enlisting the appropriate support when and where it is needed (preferably, well before it is truly necessary), energy companies can save themselves time and money and preserve the go-forward viability of their enterprise.

- **Ensure your restructuring team understands the energy industry:** The energy industry presents some unique challenges and terminology that are best understood by those professional teams that have practiced in these sectors. Choosing firms and partners with this industry-specific experience can eliminate the learning curve and inefficiencies often faced by those without the appropriate energy industry experience.

Executives shudder at the thought of restructuring or filing for bankruptcy due to an ill-placed stigma and concerns over associated costs. But if done in a timely manner and correctly, restructuring can save underperforming businesses, reduce or eliminate liabilities, and improve liquidity through contract renegotiations or asset sales—allowing unhealthy companies to live to fight another day in less-distressed times.

Hope is not a strategy. Savvy management teams will come to know the basic ins-and-outs of restructuring alternatives in the event they need to use them when the next boom becomes a bust.

Distressed energy companies can use restructuring and Chapter 11 to cut debt, manage liabilities and restore liquidity ahead of the next downturn. ■