

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

<p>In re:</p> <p>SANCHEZ ENERGY CORPORATION, <i>et al.</i>,¹</p> <p style="text-align: center;">Debtors.</p>	§ § § § § § § § §	<p>Case No. 19-34508 (MI)</p> <p>Chapter 11</p> <p>(Jointly Administered)</p>
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**AD HOC GROUP OF UNSECURED NOTEHOLDERS’ LIMITED OBJECTION
TO DEBTORS’ APPLICATION TO EMPLOY ROPES & GRAY LLP AS SPECIAL
COUNSEL TO THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS OF
SANCHEZ ENERGY CORPORATION**

(Relates to ECF No. 272)

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor’s federal tax identification number, include: Sanchez Energy Corporation (0102); SN Palmetto, LLC (3696); SN Marquis LLC (0102); SN Cotulla Assets, LLC (0102); SN Operating, LLC (2143); SN TMS, LLC (0102); SN Catarina, LLC (0102); Rockin L Ranch Company, LLC (0102); SN EF Maverick, LLC (0102); SN Payables, LLC (0102); and SN UR Holdings, LLC (0102). The location of the Debtors’ service address is 1000 Main Street, Suite 3000, Houston, Texas 77002.

The ad hoc group (the “Ad Hoc Group”) of holders of unsecured notes issued by Debtor Sanchez Energy Corporation (“Sanchez Energy”, and with its affiliated debtors in possession, the “Debtors”) hereby files this limited objection to the Debtors’ application (ECF No. 272) (the “Application”) seeking an order authorizing the employment of Ropes & Gray LLP (“Ropes & Gray”) as special counsel to the special committee of the board of Sanchez Energy (the “Special Committee”). The Ad Hoc Group has concerns about the impartiality of the Special Committee and therefore requests that any order granting the Application provide that neither the Special Committee nor Ropes & Gray be authorized to conduct any investigatory work concerning the Debtors’ insiders and affiliates on behalf of the Debtors’ estates pursuant to sections 1106(a)(3) and (4) of the Bankruptcy Code.

Unremarkably, a lawyer serves at the direction of its client. Here, the Ad Hoc Group has concerns regarding apparent conflicts of interest infecting Ropes & Gray’s client—the Special Committee as led by its Chairman, Eugene Davis.

As a starting point, it is effectively conceded that Akin Gump Strauss Hauer and Feld, LLP (“Akin Gump”), the Debtors’ proposed section 327(a) counsel, labors under disabling conflicts of interest regarding its prior representations of Sanchez Oil and Gas Corporation (“SOG”), Sanchez Midstream Partners LP (“SNMP”), A.R. Sanchez, Jr, Antonio R. Sanchez, III, and other Sanchez entities. (ECF No. 268 ¶¶ 10-12²; Dizengoff Dec. ¶¶ 50-51.)

In turn, Mr. Davis—a former Akin Gump associate—enjoys a stream of personal revenue and business opportunity arising out of a deep working relationship with Akin Gump. Indeed, Mr. Davis “is or was” a corporate governor for, “among others”, more than *twenty-six entities* “to

² Debtors’ Application to Employ Akin Gump Strauss Hauer & Feld LLP as Counsel to the Debtors and Debtors in Possession (ECF No. 268) (the “Akin Application”). The declaration of Ira S. Dizengoff (the “Dizengoff Dec.”) is attached as Exhibit A to the Akin Application.

which Akin Gump serves or served as counsel.” (ECF No. 268, Dizengoff Dec. ¶ 49.) And, in *these* chapter 11 cases, Mr. Davis is being paid more than double the amount paid to other non-executive Sanchez Energy board members, including the other member of the Special Committee, because of this “particular experience in the restructuring context.”³ “Under a realistic appraisal of psychological tendencies and human weakness, where [a] relationship involves a system of referrals [as does Mr. Davis’s relationship with Akin Gump], bias is inherent and inescapable, for getting and keeping customers, is, of course, the life blood of any business.” *Midwest Generation EME, LLC v. Continuum Chem. Corp.*, 768 F. Supp. 2d 939, 943 (N.D. Ill. 2010) (internal citation and quotation omitted).

Thus, in these chapter 11 cases, Ropes & Gray appears to sit as the bottom link in a conflicted “chain of command”—*i.e.*, the Debtors’ insiders and affiliates → Akin Gump → Mr. Davis → Ropes & Gray. *In re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966) (“The conduct of bankruptcy cases not only should be right but must seem right”).

The Special Committee, led by Mr. Davis, was established in November 2018 to “conduct an investigation into, and pursue, settle, and/or otherwise resolve as the Special Committee determines to be in the best interest of Sanchez Energy, any and all actual or potential claims or causes of action Sanchez Energy has or may have related to SOG and SNMP, or their respective affiliates in connection with any actual or potential related party transaction.” App. ¶ 8. As described by the Ad Hoc Group previously (ECF No. 74), the Debtors’ estates have claims against SOG and SNMP, among others, arising from, *inter alia*, (i) Sanchez

³ See Debtors’ Emergency Motion for Entry of Interim and Final Orders (I) Authorizing Payment of Certain Prepetition Compensation Obligations; (II) Authorizing Payment of Postpetition Compensation Obligations in the Ordinary Course of Business; and (III) Granting Related Relief (ECF No. 9), Schedule I (disclosing that Mr. Davis earns a monthly salary of more than \$31,000, as compared to the average monthly compensation of non-executive board members, including Special Committee member Mr. Adam C. Zylman, of approximately \$15,000); First Day Hearing Tr., Vol. II, Aug. 13, 2019 at 89:15-23 (Counsel: “[Mr. Davis is paid twice as much as other board members because of his] particular experience in the restructuring context.”).

Energy's historic payment of 100% of the executive compensation of Msrs. Sanchez Jr. and Sanchez III, even though those individuals held director and officer roles at other affiliated and nonaffiliated entities, and managed assets for SN EF UnSub ("UnSub") and Gavilan Resources, LLC ("Gavilan"), (ii) Sanchez Energy's overpayment of general and administrative expenses to SOG pursuant to a shared services agreement, effectively subsidizing UnSub and Gavilan, (iii) SOG's adverse assertion of ownership over the critical seismic data, well logs, LAS files, scanned well documents, and other well documents and software related to and arising out of Sanchez Energy's operations, (iv) Sanchez Energy's passive and subordinate agreement (twice) in 2019 to pay increased tariffs to SNMP without receiving fair consideration in return, and (v) Sanchez Energy's 2018 dedication of Comanche acreage to the affiliated Carnero joint venture without receiving fair consideration in return and allowing SNMP to sustain its 50% ownership therein. These related-party transactions warrant an unbiased investigation by the statutory creditors' committee under section 1103 or by a trustee or examiner under section 1106—not by a conflicted debtor in possession.

In addition, the Ad Hoc Group's concern regarding Ropes & Gray is exacerbated by the fact that the firm substantially completed its investigation prepetition. App. ¶ 10. Ropes & Gray has been paid approximately \$5 million for its work in connection with the Special Committee's investigation and, upon information and belief, has already produced a draft report of the Special Committee's findings. To be certain, neither the Ad Hoc Group (nor the Ad Hoc Group of Secured Noteholders) were ever interviewed in connection with—or even informed of—Ropes & Gray's work-stream at any time. The creditors of these bankruptcy estates did not learn of Ropes & Gray's retention until reviewing the Debtors' first day declaration.

The prepetition work done by Ropes & Gray raises two issues. *First*, it injects an

inherent bias on Ropes & Gray as proposed counsel to *the debtors in possession* (as distinct from the debtors). *In re Braniff Airways, Inc.*, 42 B.R. 443, 449 (Bankr. N.D. Tex. 1984) (“the debtor and the debtor-in-possession are separate and distinct entities”). Ropes & Gray was conducting analysis at a time when, quite possibly, its client believed that its duties extended solely to parties *other than* creditors. *Compare Fagan v. La Gloria Oil & Gas Co.*, 494 S.W.2d 624, 628 (Tex. Civ. App. 1973) (breaches of fiduciary duties “neither create a cause of action in a creditor of the corporation for the wrong done the [sic] corporation nor, without more, entitled the creditor to collect his claim from the officers and directors”)⁴ *with Commodity Futures Trading Comm’n v. Weintraub*, 471 U.S. 343, 355 (1985) (debtor in possession has fiduciary obligations to creditors); *In re Continental Air Lines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986) (same).⁵ Post-petition, it is highly unlikely that Ropes & Gray, now as proposed counsel to the debtors in possession, would do anything other than reaffirm its prepetition work product.

Second, in view of the fact that Ropes & Gray has substantially completed its work, there is no practical reason for it to “investigate” further. This is particularly true when an unbiased official creditors’ committee is tasked with conducting the investigation in bankruptcy. 11 U.S.C. § 1103.

In light of the foregoing, the Ad Hoc Group respectfully requests that any order authorizing the Special Committee to retain Ropes & Gray as special counsel expressly provide that the Special Committee is *not* authorized to conduct an investigation under section 1106(a)(3) of the Bankruptcy Code or file any “statement of investigation [concerning] the management of

⁴ The Ad Hoc Group asserts that the prepetition Debtors had a duty to preserve assets for the benefit of creditors. *In re Rajabali*, 365 B.R. 702, 708 (Bankr. S.D. Tex. 2007) (citing *Fagan*).

⁵ This bias may already be evident in these chapter 11 cases: the Special Committee and Ropes & Gray have thus far denied requests from the official committee of unsecured creditors and the Ad Hoc Group—the residual stakeholders in these bankruptcy cases—to turn over any purported investigation report.

the affairs of the debtor” with the Court. 11 U.S.C. §§ 1106(a)(3), (4). Moreover, the Ad Hoc Group expressly reserves all of its rights under: (I) section 330 of the Bankruptcy Code (in the event Ropes & Gray conducts work that is not in the estates’ best interests); (II) *In re Foster Mortg. Corp.*, 68 F.3d 914, 917 (5th Cir. 1995) (in the event Ropes & Gray seeks to settle claims against affiliates and insiders of the Debtors over the objections of creditors); and (III) *Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233, 252-53 (5th Cir. 1988) (because the Ad Hoc Group does not believe the Special Committee will ever vigorously prosecute claims against affiliates and insiders of the Debtors).

Respectfully submitted this 27th day of September, 2019.

**QUINN EMANUEL URQUHART &
SULLIVAN, LLP**

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***Counsel to the Ad Hoc Group of Unsecured
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CERTIFICATE OF SERVICE

I, Patricia B. Tomasco, hereby certify that on the 27th day of September, 2019, a copy of the foregoing document was served via first class mail, postage prepaid, or the Clerk of the Court through the ECF system to the parties on the attached service list.

/s/ Patricia B. Tomasco

Patricia B. Tomasco

Label Matrix for local noticing 0541-4 Case 19-34508 Southern District of Texas Houston Fri Sep 27 09:33:23 CDT 2019	Ad Hoc Group of Unsecured Noteholders c/o Patricia B. Tomasco Quinn Emanuel Urquhart & Sullivan LLP 711 Louisiana, Suite 500 Houston, TX 77002-2721	Archrock Partners Operating LLC and Archrock 9807 Katy Freeway, Ste. 100 Houston, TX 77024-1276
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Bottom Line Services, LLC c/o Scott D. Lawrence Akerman LLP 2001 Ross Ave Suite 3600 Dallas, TX 75201-2938	Delta Lake Irrigation District c/o John T. Banks 3301 Northland Dr., Ste. 505 Austin, TX 78731-4954	Dilley ISD 711 Navarro, Suite 300 San Antonio, TX 78205-1749
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Elliott Electric Supply, Inc. c/o Misti L. Beanland, Esq. Matthews. Shields, Knott, LLP 8131 LBJ Freeway Suite 700 Dallas, TX 75251-1352	Excalibur Rentals c/o John Massouh SPROUSE SHRADER SMITH PO BOX 15008 AMARILLO, TX 79105-5008	Frio Hospital District 711 Navarro, Suite 300 San Antonio, TX 78205-1749
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(u)Rusco Operating, LLC

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(u)Sanchez Oil & Gas Corporation

(u)Starr County

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(u)Tulsa Inspection Resources LLC

(u)Willacy County

(u)Wilmington Savings Fund Society, FSB

(u)Zavala CAD

(d)Innovex Downhole Solutions, Inc.
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 Total 141