

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

IN RE: § Chapter 11
§
LUCA INTERNATIONAL GROUP LLC¹ § CASE NO. 15-34221-H2-11
§
§ Joint Administration Pending
Debtors § Judge David R. Jones
§
§

**EMERGENCY MOTION FOR ENTRY OF AN ORDER APPROVING DEBTOR LUCA
OPERATION’S PAYMENT OF PRE-PETITION COMPENSATION, EMPLOYEE
BENEFITS, AND TAXES**

THIS MOTION SEEKS AN ORDER THAT MAY ADVERSELY AFFECT YOU. IF YOU OPPOSE THE MOTION, YOU SHOULD IMMEDIATELY CONTACT THE MOVING PARTY TO RESOLVE THE DISPUTE. IF YOU AND THE MOVING PARTY CANNOT AGREE, YOU MUST FILE A RESPONSE AND SEND A COPY TO THE MOVING PARTY. YOU MUST FILE AND SERVE YOUR RESPONSE WITHIN 23 DAYS OF THE DATE THIS WAS SERVED ON YOU. YOUR RESPONSE MUST STATE WHY THE MOTION SHOULD NOT BE GRANTED. IF YOU DO NOT FILE A TIMELY RESPONSE, THE RELIEF MAY BE GRANTED WITHOUT FURTHER NOTICE TO YOU. IF YOU OPPOSE THE MOTION AND HAVE NOT REACHED AN AGREEMENT, YOU MUST ATTEND THE HEARING. UNLESS THE PARTIES AGREE OTHERWISE, THE COURT MAY CONSIDER EVIDENCE AT THE HEARING AND MAY DECIDE THE MOTION AT THE HEARING.

REPRESENTED PARTIES SHOULD ACT THROUGH THEIR ATTORNEYS.

EMERGENCY CONSIDERATION OF THIS MOTION HAS BEEN GRANTED. BECAUSE THE COURT WILL CONSIDER THE MOTION ON AN EMERGENCY BASIS, YOU WILL HAVE LESS THAN 14 DAYS TO ANSWER. IF YOU OBJECT TO THE REQUESTED RELIEF OR IF YOU BELIEVE THAT THE EMERGENCY CONSIDERATION IS NOT WARRANTED; YOU SHOULD FILE AN IMMEDIATE RESPONSE.

¹ The Debtors in these cases, along with the last four digits of their respective taxpayer ID numbers, are Luca International Group LLC (1086), Luca Operation, LLC (0343), Luca International Group (Texas) LLC (5577), Luca Barnett Shale Joint Venture, LLC (5340), Luca Energy Fund LLC (0677), Luca Energy Resources, LLC (0000), Luca Resources Group, LLC (1699), Luca I, LP (4104), Luca II, LP, (9778), Luca Oil, LLC (8161), Luca To-Kalon Energy LLC (3922), Luca Oil II Joint Venture (6604).

TO THE HONORABLE UNITED STATES BANKRUPTCY COURT:

Luca International Group, LLC (“LIG”), Luca International Group (Texas) LLC (“LIGTX”), Luca Operation, LLC (“LOL”), Luca Barnett Shale Joint Venture, LLC (“LBSJV”), Luca Energy Fund LLC (“LEF”), Luca Energy Resources, LLC (“LER”), Luca Resources Group, LLC (“LRG”), Luca I, LP (“Luca I”), Luca II, LP (“Luca II”), Luca Oil, LLC (“Luca Oil”), Luca To-Kalon Energy, LLC (“LTKE”), and Luca Oil II Joint Venture (collectively “Debtors”), file this *Emergency Motion for Entry of an Order Approving Payment of Pre-Petition Compensation, and Taxes* (“Motion”). The grounds for this motion are:

SUMMARY OF EMERGENCY

1. An emergency exists because this case was filed during the Debtor LUCA Operation, LLC’s regular payroll cycle. Debtor owes current employees for prepetition wages, benefits and expense reimbursements for the period of August 1, 2015 through August 5, 2015. These prepetition sums are scheduled to be paid on or about August 15, 2015. If the Debtor is not allowed to timely pay these sums, it is likely to lose valuable employees.

I. Jurisdiction

2. This Court has jurisdiction by virtue of 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A) and (M).

II. Venue

3. Venue is proper in this district pursuant to 28 U.S.C. § 1408(1) & (2) because the Debtor’s principal places of business have been located in this district for more than 180 days preceding the filing of these bankruptcy cases.

III. BACKGROUND INFORMATION

A. Overview of the Debtors

4. The above captioned bankruptcy cases were each filed on August 6, 2015 (collectively "Petition Date") under Chapter 11 of Title 11 of the Bankruptcy Code, 11 U.S.C. §§101 *et seq.* (the "Bankruptcy Code"). The Debtors continue to manage their property as debtors-in-possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code. A Motion seeking joint administration of these cases was filed on August 6, 2015 (Docket #2) and remains pending before the Court.

5. No trustee or examiner has been appointed in the Debtors' bankruptcy cases and no official committee of unsecured creditors has been established.

6. A detailed factual background of the Debtors' business and operations, as well as the commencement of these Chapter 11 cases, is more fully set forth in the *Affidavit of Loretta R. Cross in Support of the Debtors' Chapter 11 Petitions and Requests for First-Day Relief* filed contemporaneously herewith and incorporated herein by reference. A brief summary of the factual background is listed below.

7. The Debtors are engaged in the exploration and production of natural gas, petroleum and related hydrocarbons. Bingqing Yang ("Yang") is the sole member for Debtors. Debtors obtained money from investors that was placed into various entities that were utilized in the operations of other entities.

8. LOL has a draft reserve report that was prepared in March by Gustavson Associates. The reserve report indicates that LOL has proved developed non-producing and proved behind pipe net reserves of approximately 3.2 billion cubic feet of gas and 450 million barrels of oil. The reserve report did not address proved undeveloped, probable or possible

reserves.

9. On July 6, 2015, under Case No. 15-cv-03101, the Securities and Exchange Commission (“SEC”) filed a lawsuit against several LUCA entities, including the Debtors, other Debtor affiliates, Yang and certain other individuals in the United States District Court of the Northern District of California, San Francisco Division (“SEC lawsuit”). The SEC lawsuit alleged securities fraud against the defendants for a scheme targeting the Chinese American community as well as investors in Asia to invest in the various unregistered offerings. There are SEC allegations of funds being used for Bingqing Yang’s personal expense. The SEC has sought the appointment of a receiver, and this matter remains pending.

10. In order to restore credibility to the operation, the Debtors, pursuant to various consents executed by Yang, retained Loretta R. Cross of Stout Risius Ross, Inc. as Chief Restructuring Officer (the “CRO”) of the Debtors with full authority to operate the Debtors. Ms. Cross has served in that capacity since July 16, 2015.

11. LOL has reduced the number of employees to a core group. This core group is essential to efficiently liquidate the Debtors’ assets. The core group of employees includes: the Chief Operating Officer, the General Manager, two bookkeepers, a Chinese translator/analyst and a geologist. In addition, there is a contract controller on staff and a contract lease manager available as needed. In conjunction with the filing, the CEO will be stepping down and serve in a consulting role. A redacted list of the employees, their titles, their compensation, and the amount owed as of the filing date is attached to the Motion as Exhibit A.² We will continue to find ways to reduce the staff as operations are curtailed.

12. Continued service by the Debtors’ employees is vital to the Debtors’ successful

² An unredacted list will be provided to the Court and U.S. Trustee.

asset sale and the Debtors' ability to address issues related to untangling the complex series of intercompany transactions. All of the Debtors' remaining employees have skills and specialized knowledge that are critical to the Debtors' sale. While the Debtors could try to replace these individuals or conduct a sale without them, it would take time, money, and likely delay the efforts to maximize hydrocarbon production and the value realized in an auction.

13. Many of the Debtors' employees simply cannot afford to miss a paycheck and any disruption in pay will most certainly result in some employees seeking employment elsewhere. Accordingly, it is absolutely critical to the Debtors' efforts that the Debtors maintain their employees and continue to compensate their employees in the ordinary course. Accordingly, the Debtors seek authority to honor the various categories of employee obligations including employee compensation and payroll taxes, accrued vacation pay plans, outstanding expense reimbursements and health care benefits.

IV. BUSINESS REASONS JUSTIFY KEEPING EMPLOYEES

14. LOL currently has six employees: the Chief Operating Officer, the General Manager, two bookkeepers, a Chinese translator/analyst and a geologist. In addition, there is a contract controller and a contract lease manager available as needed (collectively "Employees"). Retention of these employees is critical to the Debtors' continued operation. Total prepetition compensation and benefits will not exceed \$27,542.86³.

15. The Employees are all highly skilled in their respective positions and are extremely valuable to Debtors' continued operations.

16. As defined herein, Prepetition Employee Claims exist because this case was filed during LOL's regular payment cycle. LOL last paid its employees on July 31, 2015, for the week

³ Total of \$14,721.83 in Employee Obligations, \$4,640.28 in prorated payroll taxes, and \$8,180.75 in accrued vacation.

ending July 31, 2015. Thus, Employees are owed for current, accrued, but still unpaid services, rendered from August 1, 2015 through the Petition Date. These payroll obligations are scheduled to be paid on August 15, 2015. By this motion, LOL is seeking to pay prepetition wages (including overtime, if any), expenses, benefits and applicable taxes, totaling no more than \$27,542.86. For purposes of maintaining the privacy of LOL's employees, a detailed list of amounts owed with respect to each of these items will be provided to the Court at the hearing scheduled on this motion.

17. Debtor's Employees, except for the contract controller and contract lease manager, are paid annual salaries. While Debtor seeks permission to pay these employees on an emergency basis, all payments of prepetition wages and expenses will be below the \$12,475 priority claim those employees would hold under 11 U.S.C. §507(a)(4).

18. All the employees are owed or have accrued wages, salaries and expenses, in the ordinary course of LOL's business (collectively, the "Payroll Obligations"), benefit contributions, including, but not limited to, medical insurance, group dental, vision, life insurance, long-term and short term disability (collectively "Employee Benefit Contributions") prior to the Petition Date. Vacation accrues pro rata over a calendar year; therefore, some employees have accrued vacation as of the Petition Date.

19. LOL must also ensure that federal income tax, insurance, and social security and medicare taxes (collectively, the "Tax Obligations"), among other assessments, are properly withheld from its employees' payroll. (The Payroll Obligations, the Employee Benefit Contributions, and the Tax Obligations are together collectively referred to as the "Prepetition Employee Claims").

20. Employee Benefit Contributions. LOL provides general welfare benefits to

employees including but not limited to and medical health, dental, life and vision insurances, short and long term disability insurance and maintains responsibility for administering the same, including making payments to the health insurance providers with respect to each of the plans. These benefits are provided by Blue Cross/Blue Shield and Guardian. Health care benefits are paid through August 15, 2105.

21. 401(k) Savings Plan. The Debtor does not offer a 401(k) savings or similar plan to its employees.

22. Tax Obligations. LOL withholds federal, state, and local employment-related taxes, including federal income taxes, Medicare and social security taxes, and state unemployment insurance from wages and salaries of its employees. LOL pays the appropriate insurance or governmental authority and requests permission to pay all outstanding prepetition amounts owed in connection with this obligation (“Tax Obligations”).

V. Relief Sought

23. By this Motion, LOL requests, pursuant to Sections 363(b), 365, 549 and 105(a) of the Bankruptcy Code, that the Court authorize LOL to pay the Prepetition Employee Claims described herein. LOL also requests authority to continue performing employee-related Employee Plans and programs, plans, and policies as in effect on the Petition Date in the ordinary course of the LOL’s business. An emergency hearing on this Motion is necessary because any delay in paying the Prepetition Employee Claims would undermine LOL’s relationship with its Employees and sap the Employees’ morale.

24. Specifically, LOL requests that this Court authorize, up to \$12,475.00 per employee:

- a. the payment of Payroll Obligations, and Tax Obligations;

- b. authorize LOL to continue to honor LOL's Employee Plans, policies and programs with respect to the accrued leave and all vacation, sick-leave, and related policies, as such plans, policies and programs were in effect as of the Petition Date, including the payment of prepetition amounts as they come due in the ordinary course of business, without such conduct and payment being deemed an assumption of said plans, policies and programs;

25. Pursuant to Sections 507(a)(4) and 507(a)(5) of the Bankruptcy Code, claims against LOL for "wages and salaries, including vacation severance and sick leave pay," earned within one hundred eighty (180) days before the Petition Date, and claims against LOL for contributions to employee benefit plans arising from services rendered within 180 days before the Petition Date, are entitled to unsecured priority status to the extent of \$12,475.00 per Employee.

26. Specifically, LOL submits that failure to continue current policies regarding benefits will undermine the Employees' morale by potentially subjecting them to considerable personal hardship (including the loss of their expected benefits and in some cases an immediate inability to meet basic living expenses). The mass employee departure that would result from such a breach of trust by LOL would destroy any prospect for a successful bankruptcy process.

27. A bankruptcy court may authorize the payment of prepetition obligations when necessary to facilitate a debtor's reorganization. See, e.g., *In re Equalnet Communications Corp.*, 258 B.R. 368 (Bankr. S.D. Tex. 2000). This authority stems from the common-law "necessity of payment" doctrine, which courts have applied when the failure to pay prepetition obligations poses a real and significant threat to a debtor's reorganization. See *Dudley v. Mealey*, 147 F.2d 268 (2d Cir. 1945), cert. denied 325 U.S. 873 (1945). In a well-established line of cases, this doctrine was first applied in conjunction with railroad reorganizations. See, e.g.,

Gregg v. Metropolitan Trust Co., 197 U.S. 183 (1905) (“the payment of the employees of the [rail]road is more certain to be necessary in order to keep it running than payment of any other class of previously incurred debt”); *Miltenberger v. Logansport, Crawfordsville & Southwestern Railway Co.*, 106 U.S. 286 (1882) (permitting the payment of pre-receivership claim prior to reorganization in order to prevent the cessation of “indispensable business relations”).

28. The “necessity of payment” doctrine was eventually expanded beyond railroad reorganizations, beginning with *Dudley v. Mealey*. 147 F.2d 268. In *Dudley*, the court held that the creditors’ interest in continuing the debtor’s hotel business justified paying the prepetition claims of creditors who furnished supplies essential to keeping the hotel open. *Id.* at 271. Numerous courts have applied *Dudley*’s doctrine in situations similar to this Case, recognizing that the payment of certain prepetition wage, salary, medical-benefit, and business-expense claims was justified since no business debtor can hope to reorganize without the cooperation of its employees. *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175-76 (Bankr. S.D.N.Y. 1989).

29. The modern analogue to the “necessity of payment” doctrine appears in Section 105(a) of the Bankruptcy Code, which provides, in pertinent part: “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). This includes the power to authorize the payment of the Prepetition Employee Claims, including the Services Payroll Payment.

30. Authorizing the Prepetition Employee Claims is essential to LOL’s prospect for successfully emerging from Chapter 11. If these claims are not satisfied, the Employees will suffer and may find themselves unable to meet their most basic needs. Furthermore, they will likely abandon LOL for other employers, and LOL will find the prospects for a successful reorganization doomed from the start. The Employees’ specialized skills are essential to LOL

and represent their most critical resource. Any failure to pay the Prepetition Employee Claims will deprive LOL of a genuine opportunity at a “fresh start.”

31. By the same token, it is also crucial that LOL honor its existing policies and programs regarding vacation and sick leave, and that it meet any further obligations as they come due in the ordinary course of business. The Employees expect LOL to meet these obligations, and any chance that it might not will likely spur the Employees to look for work elsewhere.

32. LOL also request that all financial institutions be authorized to honor all post-petition checks issued or to be issued from the Debtors’ accounts, and fund transfers requested or to be requested, by the Debtors in respect of the Prepetition Employee Claims.

WHEREFORE, Debtor respectfully pray that the Court approve this Motion in its entirety and grant all the relief requested herein and grant the Debtor such further relief as it deems just and proper.

DATED: August 6, 2015

Respectfully submitted,

HOOVER SLOVACEK LLP

/s/ Brendetta A. Scott

By: _____

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PROPOSED ATTORNEYS FOR DEBTOR

Verification

The factual statements in paragraph 1 is true and correct within my own personal knowledge. In my opinion, a genuine emergency exists that requires consideration of this matter in order to avoid hardship to the bankruptcy estate, and so that the Debtors can maintain its operations and control of its assets. I certify under penalty of perjury that the foregoing is true and correct.

/s/ Brendetta A. Scott
BRENETTA A. SCOTT

EXHIBIT A

Pre-petition Wages/Salaries & Benefits