

In Re:

Debtor.

Plaintiff,

V.

Defendant.

Adv. Proc. No. 05-03640

As the Chief Executive Officer of Retail Concepts, Inc., I am experienced with solvency and preference-related issues in bankruptcy, as I was Chief Financial Officer for Retail Concepts, Inc. before, during and after their emergence as a reorganized debtor from Chapter 11 on two occasions, during 1990-91 and 2002-03.

Assignment

Analyze the payments by Dunhill Resources, Inc. ("DRI") to Century Exploration Company totaling \$556,375.38 to confirm:

- Whether or not the payments were transfers from DRI to Century Exploration Company,
- Whether or not DRI received less than a reasonably equivalent value in exchange for such transfers, and
- Whether or not DRI was insolvent at the time that each of the transfers was made.

Subject Transfers

Based upon the allegations in the complaint, Jeffrey A. Compton, Trustee seeks to recover the payments by Dunhill Resources, Inc. to the Defendant described in the complaint filed in the above-captioned case. The payments sought to be recovered are hereinafter referred to as the "Subject Transfers".

Opinions

1. Each of the Subject Transfers was made out of a DRI bank account and paid to Century Exploration Company.
2. DRI received less than a reasonably equivalent value in exchange for each of the Subject Transfers.
3. DRI was insolvent on a balance sheet basis at the time that each of the Subject Transfers was made.

Bases for Opinions

1. Attached hereto as Exhibit "A" is a listing of Subject Transfers made by DRI to Century Exploration Company. Each of the Subject Transfers was made from DRI's operating account number 866-2629706-65 at Chase Manhattan Bank.
2. It appears that DRI had no business dealings with Century Exploration Company and therefore, did not receive reasonably equivalent value in exchange for any of the Subject Transfers.

Per review of the Joint Owner Statements or Joint Owner Invoices from Century Exploration New Orleans, Inc., it appears that the proceeds from certain of the Subject Transfers were applied to the account of Dunhill Resources Mississippi.

3. Since inception, DRI was not reimbursed enough to cover out of pocket general and administrative expenses, per DRI's records. This was a primary factor that caused DRI to become insolvent.

The following is an excerpt from DRI's (Proposed) Disclosure Statement dated December 24, 2003:

"...At December 31, 2002, Debtor had cash balances of approximately \$0.9 million, and accounts payable to vendors of approximately \$7 million. In addition, since the acquisition of the Properties in November 2001 through December 31, 2002, the Debtor had (a) incurred approximately \$4.9 million in general and administrative expenditures in excess of the funds provided by Resources I under the Credit Agreement; (b) advanced \$2.684 million to Dunhill E&P in connection with the Dunhill E&P Note; and (c) made advances to or for the benefit of Holdings, which, in turn, made approximately \$1.85 million in payments on the Mustang Island Note.

By February 2003, the Debtor had substantially depleted its cash resources. After Concert declared the event of default under the Credit Agreement in March 2003, Concert ceased to provide the monthly allocation of four (4%) percent of net revenues for general and administrative expenses. At June 30, 2003, the Debtor had cash balances of approximately (\$.09) million, and accounts payable to vendors of approximately \$7.5 million. **From the Debtor's inception in November 2001 to June 30, 2003, the cumulative expenditures on general and administrative expenses in excess of amounts provided for under the Credit Agreement approximated \$8.9 million** (emphasis added). Also through June 30, 2003, the Debtor had advanced approximately \$3.27 million to or for the benefit of Holdings, which, in turn, used the funds to make payments on the Mustang Island Note."

There are other items that negatively impact the solvency test (i.e., adding an additional liability or reducing the book value of an asset to fair value would make DRI more insolvent):

Unrecorded Plug and Abandon Obligations ("P&A obligations") –

Per my review of DRI's records, DRI did not record liabilities for P&A obligations. Per the report of an independent petroleum engineer, DRI's exposure of P&A obligations during the eighteen-month period prior to bankruptcy was approximately \$16,544,800. Adding this liability to DRI's balance sheet would negatively impact the solvency test under the balance sheet test for solvency (i.e., adding an additional liability would make DRI more insolvent)⁽¹⁾.

Reduction of Value of Property and Equipment -

Per DRI's records, the net book value of property and equipment as of end of month July 2003 was \$1,113,940. Per DRI's Schedules filed as of the petition date, the market value of the property and equipment was \$115,170. Additionally, subsequent to the petition date, DRI's property and equipment was sold to a third party for a total price of \$115,170. Thus, it appears that the fair value of DRI's property and equipment was substantially less than the net book value per DRI's records. This difference would negatively impact the solvency test.

Capitalization of DRI was minimal. DRI was incorporated in July 2001. In November 2001, Dunhill Resources Holdings, LLC ("Holdings") was formed. The stock of DRI was contributed as a capital contribution to Holdings in the amount of \$810, resulting in an 81% ownership of Holdings.

Per DRI's Schedules filed as of the petition date, the amount of liabilities was more than 5 times the amount of assets. Total assets were listed as \$9,752,909 and total liabilities were listed as \$50,741,616.

Per DRI's records, significant operating losses were generated every month since inception⁽²⁾ (see Exhibit "B" attached).

Per DRI's records, DRI's principal assets were (i) cash, (ii) receivables, (iii) prepaids, (iv) deposits and (v) property and equipment. None of these assets appear to be appreciable property. Additionally, with the exception of one property, DRI did not own an interest in the properties it operated. Based on the report of an independent petroleum engineer, that property had no net value.

Per Section 101 (32)(A) of the Bankruptcy Code, the definition of "insolvent" is as follows:

...with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of –

- (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and
- (ii) property that may be exempted from property of the estate under section 522 of this title.

(1) Per my review of DRI's records, DRI did not record amounts paid as escrow deposits as a separate line item on its books during the 90 days prior to bankruptcy. As of the petition date, the amount of funds in the escrow account was \$7,556,117. However, this amount is substantially less than the estimated P&A obligations of \$16,544,800 during the eighteen-month period prior to bankruptcy.

(2) DRI was incorporated in July 2001. Records for operating losses were provided beginning October 2001. Per DRI's records, cumulative operating losses from inception through September 30, 2001 were \$61,025. Thus, it was assumed that monthly operating losses incurred during each of the months July through September 2001.

Information Considered

In preparing these opinions I relied upon the following documents:

- Dunhill Resources, Inc.'s (Proposed) Disclosure Statement under 11 U.S.C. 1125 and Bankruptcy Rule 306 in Support of Amended Plan of Reorganization
- Dunhill Resources, Inc.'s (Proposed) Amended Plan of Reorganization
- Dunhill Resources, Inc.'s Statement of Financial Affairs
- Southern District of Texas Claims Register for Dunhill Resources, Inc.
- Dunhill Resources, Inc.'s Schedules A, B, D, E, F, G and H regarding schedules filed in Case No. 03-41264-H5-11

- Motion of the Official Committee of Unsecured Creditors for Appointment of a Chapter 11 Trustee regarding Dunhill Resources, Inc. as debtor
- Transition Services Agreement by and between Dunhill Resources I, LLC, Dunhill Resources Holdings, LLC, Dunhill Resources, Inc., John M. Hall, Dunhill Resources II, LLC, Concert Capital Resources A, L.P., Concert Capital Resources B, L.P., Concert Capital Resources C, L.P., Concert Capital Resources C, Inc., Concert Capital Resources A/B, Inc. and Concert Capital Resources, L.P.
- Dunhill Resources Global Escrow and Security Agreement
- Dunhill Resources, Inc. Bond/Lease Schedule
- Letter from TETRA Applied Technologies, L.P. to Jeffrey A. Compton dated July 8, 2005
- Assignment, Assumption and Consent Agreement
- Monthly Operating Report Summary for Month of August 2005 for Dunhill Resources, Inc. prepared by Jeffrey A. Compton, Trustee
- Dunhill Resources, Inc.'s general ledger for the period beginning October 2001 through August 2003 (the months of May 2002 and June 2002 are missing)
- Dunhill Resources, Inc.'s U. S. Corporation Income Tax Returns for 2001, 2002 and 2003
- Certain financial information prepared by Grant Thornton
- Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations
- Reports of Pressler Petroleum Consultants, Inc.
- Credit Agreement between Dunhill Resources I, LLC and Aquila Energy Capital Corporation dated as of November 13, 2001
- Certain bank statements of Dunhill Resources, Inc.
- Account reconciliation related records
- Copies of canceled checks representing transfers to defendant
- Complaint to Avoid and Recover Transfers
- Century Exploration New Orleans, Inc. f/k/a Century exploration Company's Answer to Complaint to Avoid and Recover Transfers
- Copy of memo from Snow Fogel Spence to Mr. Michael S. Wilk dated June 22, 2006
- Copies of Joint Owner Statement and Joint Owner Invoices from Century Exploration New Orleans, Inc.

I reserve the right to amend and supplement this opinion as additional information becomes available.

Signed,

B. Frank Stanley
B. Frank Stanley, CPA

Qualifications of B. Frank Stanley

Education

Texas A & M University, B. A. Degree 1977 with major in Accounting.

Professional Status

Passed C.P.A. examination November, 1980

Certified Public Accountant licensed in Texas

Professional Affiliations

American Institute of Certified Public Accountants

Employment

1988 – Current

Employed by Retail Concepts, Inc. (d.b.a. Sun & Ski Sports and Ski Chalet), a specialty retailer with 18 stores, from 1988 – 1995 as Chief Financial Officer, from 1995 – 2001 as Chief Operating Officer and from 2002 – current as Chief Operating Officer/Chief Financial Officer.

1987 – 1988

Employed by Southpoint Porsche Audi WGW LTD, a car dealership, as Chief Financial Officer.

1985 – 1987

Employed by KPMG Peat Marwick, a provider of audit, tax and consulting services, as Staff Accountant, Supervising Senior Accountant and Manager in the audit department.

1983 – 1984

Employed by Design Research, Inc., a manufacturer of housing for offshore drilling platforms, as Chief Financial Officer.

1980 – 1982

Employed by Tiger Oilfield Rental Co., Inc., a company specializing in the rental of oilfield equipment, as Chief Financial Officer.

1977 – 1979

Employed by Trunkline Gas Co., an operator of a pipeline system, as Accountant.

EXHIBIT "A"

<u>TRANSFeree</u>	<u>CHECK NUMBER</u>	<u>CHECK DATE</u>	<u>PAID DATE (CLEARED BANK)</u>	<u>CHECK AMOUNT</u>
CENTURY EXPLORATION COMPANY	10240	2/15/2002	2/25/2002	\$1,064.39
CENTURY EXPLORATION COMPANY	11022	5/9/2002	5/15/2002	\$78,414.97
CENTURY EXPLORATION COMPANY	11023	5/9/2002	5/16/2002	\$136,345.11
CENTURY EXPLORATION COMPANY	11180	5/23/2002	6/13/2002	\$1,172.19
CENTURY EXPLORATION COMPANY	11756	7/25/2002	7/29/2002	\$143,501.37
CENTURY EXPLORATION COMPANY	11928	8/2/2002	8/12/2002	\$6,654.64
CENTURY EXPLORATION COMPANY	12249	8/27/2002	9/5/2002	\$5,399.16
CENTURY EXPLORATION COMPANY	12695	10/4/2002	10/22/2002	\$5,616.24
CENTURY EXPLORATION COMPANY	12785	10/24/2002	12/30/2002	\$5,995.56
CENTURY EXPLORATION COMPANY	13314	12/26/2002	1/2/2003	\$15,270.78
CENTURY EXPLORATION COMPANY	13417	1/16/2003	1/21/2003	\$48,837.80
CENTURY EXPLORATION COMPANY	13420	1/24/2003	2/3/2003	\$5,912.98
CENTURY EXPLORATION COMPANY	13421	1/24/2003	2/3/2003	\$14,158.00
CENTURY EXPLORATION COMPANY	13873	3/14/2003	3/25/2003	\$14,484.08
CENTURY EXPLORATION COMPANY	14021	4/23/2003	4/30/2003	\$17,193.81
CENTURY EXPLORATION COMPANY	14025	4/30/2003	5/7/2003	\$26,954.36
CENTURY EXPLORATION COMPANY	14250	6/12/2003	6/25/2003	\$13,909.54
CENTURY EXPLORATION COMPANY	14342	7/24/2003	8/20/2003	<u>\$15,490.40</u>
TOTAL PAYMENTS				\$556,375.38

Dunhill Resources, Inc. Monthly Operating Losses Since Inception

Note: These figures were obtained from the books and records of Dunhill Resources, Inc.