



OCS ADVISORY BOARD

WINTER WORKSHOP
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Assignee/Assignor Liability and the OCS

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Overview of the Presentation

- Sources of Assignor/Assignee Liability on the OCS
 - Contract Assignments
 - Regulations
 - Stress “Testing” – Contracts and the Regulations in bankruptcy.
- BOEM/BSEE Regulations enforcement discussion
 - Review of select BOEM “assignment” and “liability” provisions
 - Review of recent IBLA opinions
 - Discussion of Bankruptcy Case Settlements/Lessons Learned
- Is a “New Age Dawning”?
 - What is past prologue: Will yesterday’s deal structures and security devices work in the future?
 - Aligning industry Agreements with changing regulations
 - Drafting considerations for OAs and PSAs

Sources of Assignor/Assignee Liability on OCS

- Contractual:
 - OCS Lease form
 - Operating Agreement
 - PSA/Assignments
 - Other Assigned Contract Liabilities
- Regulatory:
 - BOEM/BSEE Regulations – generally impose joint and several liability for all lease obligations on assignors and assignees.
 - Some recent opinions distinguish contract obligations in the OCS Lease form from the (ever changing) regulations.
 - OCS Lease form incorporates future OCS Regulations.

BOEM Regulations

- **30 CFR §250.146 – Who is responsible for fulfilling leasehold obligations?**

(a) When you are not the sole lessee, you and your co-lessee(s) are jointly and severally responsible for fulfilling your obligations under the provisions of 30 CFR parts 250 through 282 and 30 CFR parts 550 through 582 unless otherwise provided in these regulations.

(b) If your designated operator fails to fulfill any of your obligations under 30 CFR parts 250 through 282 and 30 CFR parts 550 through 582, the Regional Supervisor may require you or any or all of your co-lessees to fulfill those obligations or other operational obligations under the Act, the lease, or the regulations.

(c) Whenever the regulations in 30 CFR parts 250 through 282 and 30 CFR parts 550 through 582 require the lessee to meet a requirement or perform an action, the lessee, operator (if one has been designated), and the person actually performing the activity to which the requirement applies are jointly and severally responsible for complying with the regulation

BOEM Regulations (cont'd...)

- **30 CFR §250.1701 – Who must meet the decommissioning obligations in this subpart?**
 - (a) Lessees and owners of operating rights are jointly and severally responsible for meeting decommissioning obligations for facilities on leases, including the obligations related to lease-term pipelines, as the obligations accrue and until each obligation is met.
 - (b) All holders of a right-of-way are jointly and severally liable for meeting decommissioning obligations for facilities on their right-of-way, including right-of-way pipelines, as the obligations accrue and until each obligation is met.
 - (c) In this subpart, the terms “you” or “I” refer to lessees and owners of operating rights, as to facilities installed under the authority of a lease, and to right-of-way holders as to facilities installed under the authority of a right-of-way.

BOEM Regulations (cont'd...)

- **30 CFR §556.710 – What is the effect of an assignment of a lease on an assignor's liability under the lease?**

If you assign your record title interest, as an assignor you remain liable for all obligations, monetary and non-monetary, that accrued in connection with your lease during the period in which you owned the record title interest, up to the date BOEM approves your assignment. BOEM's approval of the assignment does not relieve you of these accrued obligations. Even after assignment, BOEM or BSEE may require you to bring the lease into compliance if your assignee or any subsequent assignee fails to perform any obligation under the lease, to the extent the obligation accrued before approval of your assignment. Until there is a BOEM-approved assignment of interest, you, as the assignor, remain liable for the performance of all lease obligations that accrued while you held record title interest, until all such obligations are fulfilled.

BOEM Regulations (cont'd...)

■ 30 CFR §250.1702 – When do I accrue decommissioning obligations?

You accrue decommissioning obligations when you do any of the following:

- (a) Drill a well;
- (b) Install a platform, pipeline, or other facility;
- (c) Create an obstruction to other users of the OCS;
- (d) Are or become a lessee or the owner of operating rights of a lease on which there is a well that has not been permanently plugged according to this subpart, a platform, a lease term pipeline, or other facility, or an obstruction;
- (e) Are or become the holder of a pipeline right-of-way on which there is a pipeline, platform, or other facility, or an obstruction; or
- (f) Re-enter a well that was previously plugged according to this subpart.

BOEM Regulations (cont'd...)

- **30 CFR §556.713 – What is the effect of an assignment of a lease on an assignee's liability under the lease?**

As assignee, you and any subsequent assignees are liable for all obligations that accrue after the effective date of your assignment. As assignee, you must comply with all the terms and conditions of the lease and regulations issued under OCSLA, and in addition, you must remedy all existing environmental and operational problems on the lease, properly abandon all wells, and reclaim the site, as required under 30 CFR part 250.

BOEM Regulations (cont'd...)

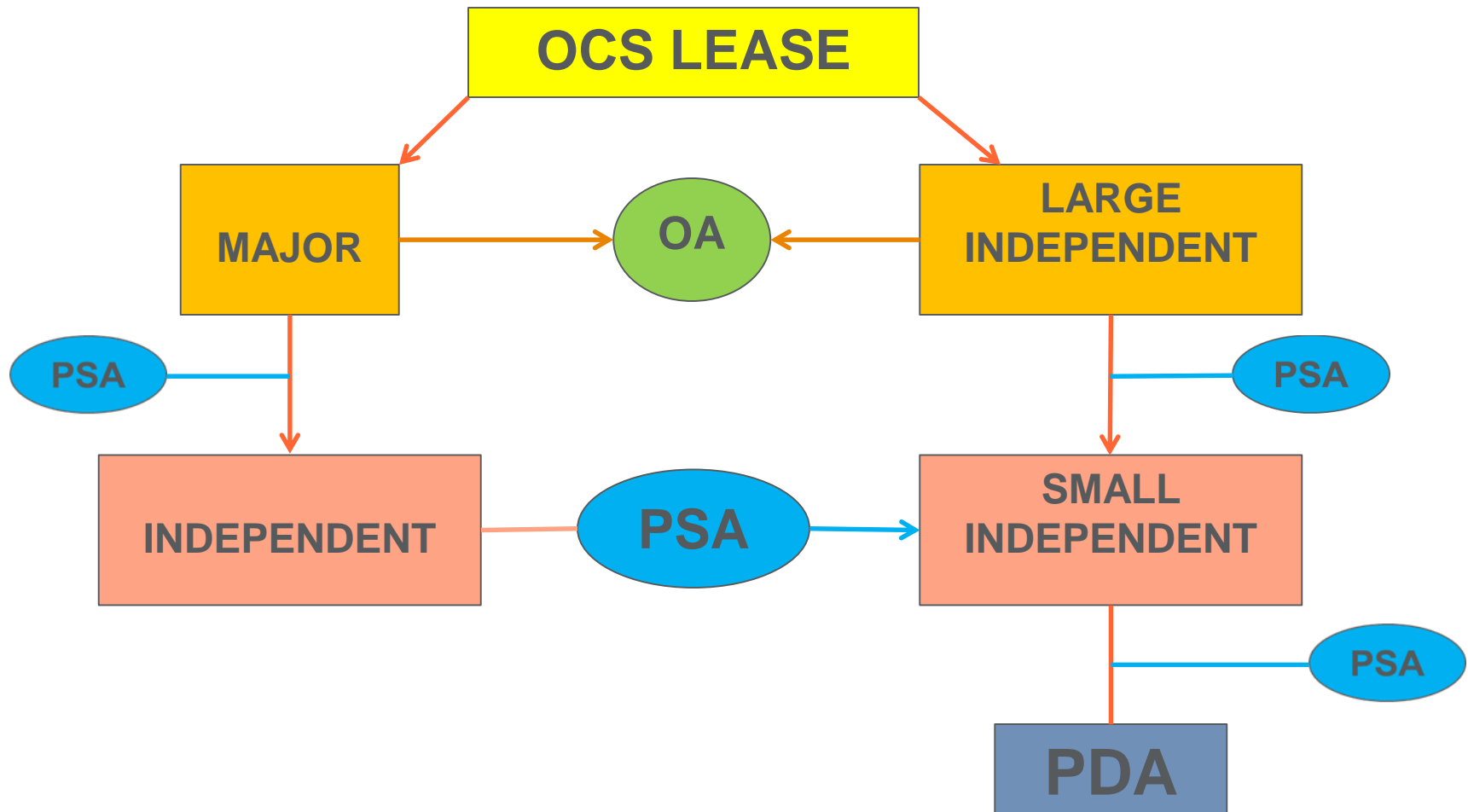
- **30 CFR §556.805 – What is the effect of an operating rights owner's assignment of operating rights on the assignor's liability?**

An operating rights owner (who does not hold record title) who assigns the operating rights remains liable for all obligations of the lease that accrued during the period in which the assignor owned the operating rights, up to the effective date of the assignment, including decommissioning obligations that accrued during that period. BOEM's approval of the assignment does not alter that liability. Even after assignment, BOEM or BSEE may require the assignor to bring the lease into compliance if the assignee or any subsequent assignee fails to perform any obligation under the lease, to the extent the obligation accrued before approval of the assignment.

Testing the Regulations

- Bankruptcy “pressure tests” contractual provisions and regulations.
- ATP bankruptcy in part, prompted BOEM NTL on financial responsibility and a sunset of old NTL on exemptions.
- ATP also ushered in a directive to “TEST THE LIMITS OF JOINT AND SEVERAL LIABILITY”

Chart re: OCS Lease



Anadarko v. BSEE/DOI

- Arises out of ATP bankruptcy in response to BSEE order to Anadarko to Decommission ST-77 a lease that was abandoned by ATP.
- Decided February 2, 2016; IBLA ruled for BSEE:
 - Because OCS leases provide that lessee is subject to “all regulations issued pursuant to OCSLA in the future,” which provide for the prevention of waste and the conservation of resources on the OCS,” Lessee takes Lease subject to future regulations (not just those in effect at the time of the lease) and Assignor under prior regulation was not released.
 - BSEE’s order was not premature because ATP had failed to perform its obligations under the lease.
 - BSEE did not err by not “going up the chain of title” in reverse chronological order.

Devon, et al. v. BSEE/DOI

- Also arises out of ATP bankruptcy in response to BSEE order to decommission ST-77.
- Decided September 15, 2016; IBLA ruled for BSEE:
 - BSEE is not required to make demand “up the chain of title” in reverse chronological order waiting for each most recent interest holder to default before taking action against earlier interest holders.
 - IBLA as an administrative body does not adjudicate whether constitutional due process rights have been violated [prior notice of supplemental bond release].
 - DOI’s alleged breach of the terms of the OCS lease did not discharge regulatory decommissioning obligations [breach = waiving supplemental bonding requirement for ATP.
 - P&A liability not limited to fixed amount of cost that existed at the time of the assignment.

EP Energy v. BSEE/DOI

- SHOCKING: Arises out of ATP bankruptcy in response to BSEE order to decommission WC-557.
- Decided August 12, 2016; IBLA ruled for BSEE:
 - BSEE properly sought to compel former Lessee to decommission Lease regardless of separate responsibility of operating rights owners.
 - Transfer of operating rights to a jointly and severally liable operator does not diminish or subordinate the liability of Lessee.
 - What about contract rights?
 - A word on the DOO form.

Virgin Oil/Offshore bankruptcy

- Filed in 2008.
- Several P&A “Plans” failed; Virgin Offshore exposures surfaced 2012/2013.
- BOEM/BSEE settled with bonding company to redirect supplemental bonds to undersecured “sole liability” leases.
- BSEE ordered former Lessee to “decommission HI-198 and did not call bond or make available supplement bond proceeds to former Lessee.
- P&A “Plan” ultimately negotiated.

Black Elk bankruptcy

- Filed in 2015 with over \$300mm in P&A liability.
- Multiple P&A Plans negotiated with active involvement from WIO's and predecessors.
- BSEE did issue multiple decommissioning orders to multiple parties (select or multiple working interest owners/predecessors) and did NOT call supplemental bonds.
- Multiple IBLA appeals filed, stays granted expect all to be dismissed due to implementation of successful P&A Plans.

Bankruptcy Lessons:

- Each case is different.
- Bankruptcy is not a spectator sport!
 - if legacy assets or current assets are implicated pay attention and start planning before bankruptcy filings.
 - when cash is directed to financial creditors, leases and OAs are abandoned and rejected and BSEE issues orders near or after confirmation, industry loses.
 - when industry is active early and pushing P&A responsibility, better results have and may be obtained.

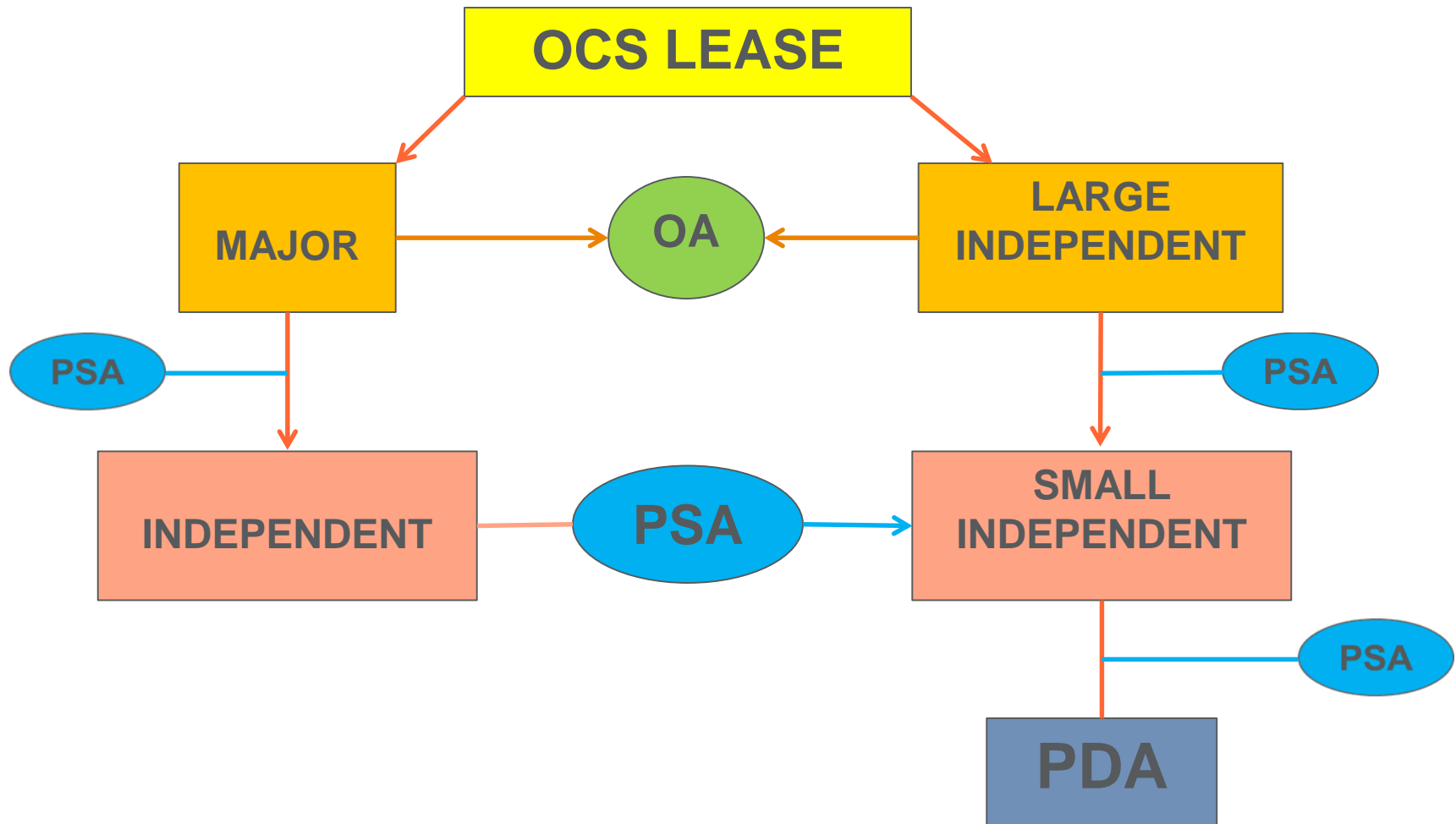
How are industry agreements “pressure tested” in bankruptcy?

- OCS Lease is generally treated by BOEM as an Executory Contract subject to § 365 of the Bankruptcy Code and can be rejected/abandoned (with the consent of the regulatory agency).
- OCS OAs have consistently been treated as executory contracts subject to § 365, which can be assumed or rejected in the exercise of the Debtor’s business judgment.
- PSAs: more complicated.
 - Be careful of efforts to keep title but reject indemnities.
 - A word on recent *ConocoPhillips v. Noble* case.

Workshop: What is Past is Prologue

- Best Practice is still to secure transactions
 - OA has security rights, if perfected, but these rights are only of value as long as lease has value/production.
 - Are decommissioning escrows viable?
 - Bonding options
 - Other security concepts (LEs, insurance)
- Are industry agreements “Aligned” with Regulations?
 - Disputes generally arise on older contracts (OAs, PSAs, farmouts, Unit Agreements)
 - Are predecessors protected under these agreements?
 - down the chain?
 - across the OA?
 - depends on the words on the page

Chart re: OCS Lease



Workshop: Drafting Considerations

- OCS Lease forms expressly incorporate certain “future” regulations [and so do other forms].
- OA form
 - Does it pick up future OCS regulations?
 - 26.4 “Catch-All” – Model OA form
 - Do the transfer provisions contractually exculpate assignors? Should they?
 - Should the OA form require security for P&A/Decommissioning on a project basis?
- PSA indemnities and assumed obligations, unless secured, are unsecured obligations only as good as the credit of the assignee.
- A word on financial security and approval of Assignments by BOEM on the “Pause”

Conclusion/Q&A



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