Offshore Oil & Gas Bankruptcy Issues

OCS Summer Seminar
Anadarko Tower

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Anticipated Topics for Analysis and Jurisprudential Development

- Application of OCSLA in Bankruptcy Proceedings
- Regulatory Issues with Enhanced Focus on Decommissioning and Financial Assurance
- Lease Maintenance and the Automatic Stay
- Issues with OCS Executory Contracts
- Increased Litigation Associated with Abandonment of Decommissioning Obligations
- Working Interest Partner Issues

Quick Overview of Key Bankruptcy Terms and Concepts

- Creation of a Bankruptcy Estate on Petition Date
- Chapter 7 or Chapter 11
- Trustees and Debtors in Possession (e.g. “DIP”)
- Automatic Stay
- Pre-Petition Claims
- Administrative Expense Claims
- Treatment of Executory Contracts
- Use, Sale and Lease of Property
- Plan of Reorganization or Liquidation?
- Absolute Priority Rule
- Preferences and Avoidance Actions
- Discharge and Injunction
- Adversary Proceedings

Application of OCSLA in Bankruptcy Proceedings

OCSLA In General

- The Outer Continental Shelf Lands Act; 43 U.S.C. §1331, et seq.
- Federal law applicable to the resources of the USA on the outer-continental shelf.
- Congressional Declaration of policy

  43 U.S.C. §1332:

  - "The OCS is a vital national resource reserve held by the Federal Government for the public, which should be made available for expeditious and orderly development, subject to environmental safeguards, in a manner which is consistent with the maintenance of competition and other national needs."
  - "Operations in the outer Continental Shelf should be conducted in a safe manner by well-trained personnel using technology, precautions, and techniques sufficient to prevent or minimize the likelihood of blowouts, loss of well control, fires, spillages, physical obstruction to other users of the waters or subsoil and seabed, or other occurrences which may cause damage to the environment or to property, or endanger life or health."

OCSLA Choice of Law Provision

- **43 U.S.C. §1333(a)(1) - Federal law, under OCSLA, applies on the OCS**

- **43 U.S.C. §1333(a)(2)(A) - OCSLA includes a choice-of-law provision that sometimes incorporates the law of the adjacent State as "surrogate" federal law:**

  > **"To the extent that they are applicable and <u>not inconsistent with [this Act and applicable regulations]</u>, the civil and criminal laws of each adjacent State are declared to be the law of the United States for the Outer Continental Shelf . . .."**

- **Non-conflicting laws of adjacent states "fill in the gaps" in OCSLA pursuant to this "mandatory" choice of law determination, which even overrides contractual choice of law provisions.**

When does OCSLA apply surrogate state law to fill the gaps?

- **Two step analysis:**

1. **When does OCSLA mandate application of adjacent state law as surrogate federal law?**

2. **If OCSLA mandates application of state law, what is the adjacent state?**

When does OCSLA apply surrogate state law to fill the gaps?

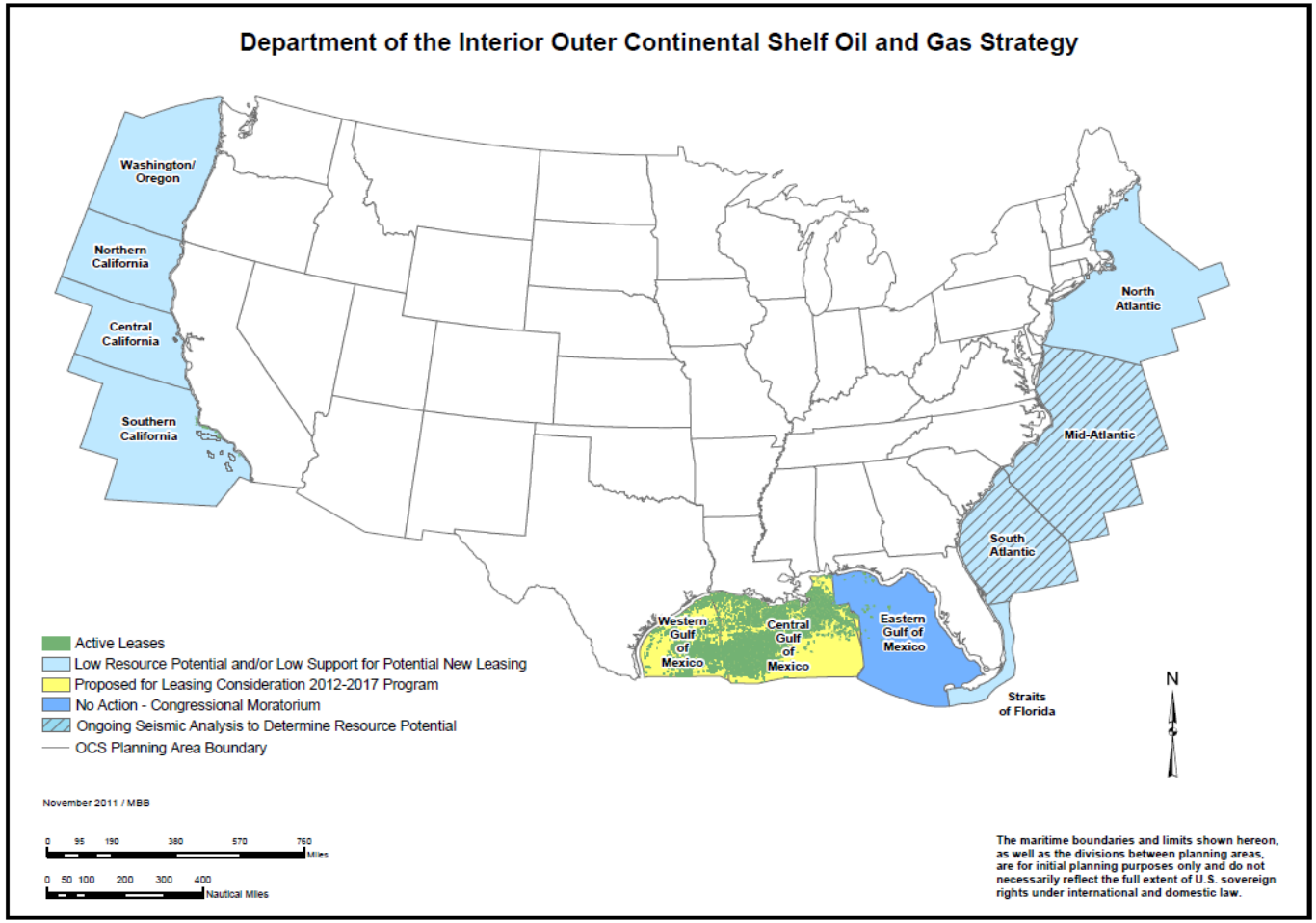
- Danos & Curole Marine Contractors, Inc. v. BP Am. Prod. Co., 61 F. Supp. 3d 679 (S.D. Tex. 2014) ("Federal law governs actions brought under OCSLA, unless there is a gap in the federal law, wherein 'the law of the adjacent state' will be used as 'surrogate federal law.'")
- Union Texas Petroleum Corp. v PLT Engineering, Inc., 895 F. 2d 1043 (5th Cir. 1990) is the leading case and applies a three part test:
  - The controversy must arise on a situs covered by OCSLA (the subsoil, seabed, or artificial structures permanently or temporarily attached thereto);
    - Tort – situs of tort
    - Contract – situs of majority of performance under the contract
  - Federal maritime law must not apply of its own force
    - Davis & Sons Inc. v. Gulf Oil Corp., 919 F.2d 313 (5th Cir. 1994) – Six factors regarding the nature and character of the contract.
  - State law must not be inconsistent with federal law.

What is the Adjacent State Law?

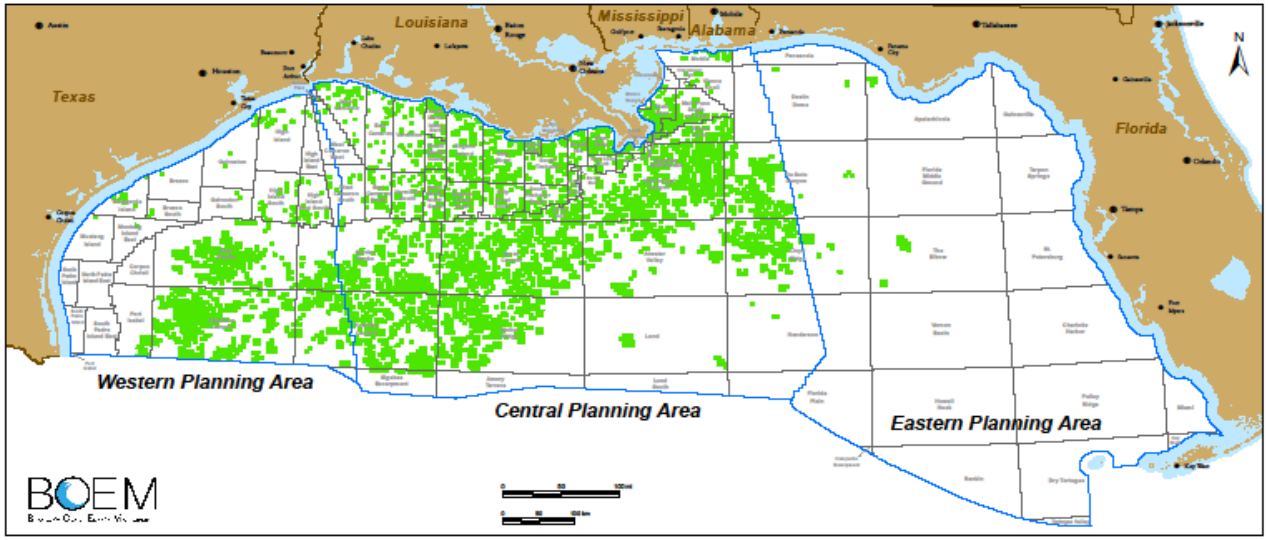
- Reeves v. B & S Welding, Inc., 897 F. 2d 178 (5th Cir. 1990)
  - Geographic proximity
  - Considerations of other federal agencies as to which state was adjacent to a particular offshore block
  - Prior court determinations
  - Projected boundaries
  - Other considerations
    - Rigs and reef blocks in area and which state is designated to share in cost savings
    - To which state does production ultimately flow
    - Which BSEE District Office is responsible for inspections
    - Interior and sub-agency projected boundaries
    - Other considerations
- Snyder Oil Corp. v. Samedan Oil Corp., 208 F.3d 521 (5th Cir. 2000)
  - Should not follow a strict formalistic test; all evidence should be considered
  - Geographic proximity is not conclusive

What is the Adjacent State Law?

- **Brown v. Total E&P USA Inc., 2008 WL 4724309 (E.D. La. 2008)**
- **Texaco Exploration and Production Inc. v. AmClyde Engineered Products, Inc., 2008 WL 782818 (E.D. La. 2008)**
- **In both of these cases, Alabama was deemed the adjacent state for facilities located in Viosca Knoll 823 and Viosca Knoll 786. Both Viosca Knoll blocks were closer as the crow flies to Louisiana but geographically south of Alabama.**


Department of the Interior Outer Continental Shelf Oil and Gas Strategy
Washington/ Oregon
Northern California
Central California
Southern California
North Atlantic
Mid-Atlantic
South Atlantic
Western Gulf of Mexico
Central Gulf of Mexico
Eastern Gulf of Mexico
Straits of Florida
N
Active Leases
Low Resource Potential and/or Low Support for Potential New Leasing
Proposed for Leasing Consideration 2012-2017 Program
No Action - Congressional Moratorium
Ongoing Seismic Analysis to Determine Resource Potential
OCS Planning Area Boundary
November 2011 / MBB
0 95 190 380 570 760 Miles
0 50 100 200 300 400 Nautical Miles
The maritime boundaries and limits shown hereon, as well as the divisions between planning areas, are for initial planning purposes only and do not necessarily reflect the full extent of U.S. sovereign rights under international and domestic law.

BOEM Gulf of Mexico OCS Region
Blocks and Active Leases by Planning Area
March 1, 2016



Planning Areas	Total Blocks	Total Acres	Number of Leases	Acres Leased
Western	5,240	28,576,813	875	4,964,842
Central	12,409	66,446,351	3,428	18,155,854
Eastern	11,537	64,357,859	48	264,030
Sub-Totals	29,186	159,381,023	4,351	23,384,726
CPA / EPA Shared Blocks*	(86)		(3)	
Totals	**29,100**	**159,381,023**	**4,348**	**23,384,726**

Active Leases

Planning Area Boundary

* CPA and EPA contain 86 shared blocks of which 3 are leased. These blocks are given both a CPA and EPA designation in the data which accounts for a higher block total.

Pulling OCSLA into Bankruptcy

- Classification of property interests in Bankruptcy is governed by non-bankruptcy law
- Property of the estate issue
  - 11 USC §541
  - Classification of OCS leases
  - ORRI's and NPI's
  - Definition of "production payment" in 11 USC §101(42A)
  - Definition of "term overriding royalty: in 11 USC §101(56A)
- On the OCS, arguably, OCSLA is the governing law for classifications of property interests in bankruptcy cases
- The question of whether federal law or the law of the adjacent state defines an OCS property interest has become unsettled

  Compare:

  - Union Texas Petroleum Corp. v PLT Engineering, Inc., 895 F. 2d 1043 (5th Cir. 1990) determined that the recordation requirements for perfecting a Louisiana LOWLA lien encumbering an OCS lease were complied with by filing notice of lien in adjacent Louisiana coastal parish (LSA R.S. 49:6 extends parish boundaries into the GoM)

    to

  - ATP Adversary proceedings whereby ATP and Interior challenge utilization of Louisiana as appropriate adjacent state surrogate federal law for application of Louisiana law to ORRI and NPI disputes

ATP Adversary Proceedings

- Prior to its bankruptcy, ATP funded certain of its operational activities through selling ORRI and NPI
- Classification of ORRI and NPI as property of the estate or not was at issue in ATP's bankruptcy
- Stage was set for an important decision affecting OCS property classifications with far reaching impact
- Extensive briefing by quality lawyers
- The definition of "production payments" included in the bankruptcy code received little consideration by the USBC SDTX
- Legal Issue:
  - Does Louisiana law, as surrogate federal law under OCSLA, determine the nature of an OCS lease, or does OCSLA itself or other federal law determine the nature of an OCS lease?
- Practical Issue:
  - Were the conveyances of the NPI and ORRI disguised financings or true conveyances?

ATP Adversary Proceedings

- Generally, the ORRI and NPI owners argued that OCSLA mandates that Louisiana law apply, and all mineral rights are therefore real rights, incorporeal immovable, and alienable under the Louisiana Mineral Code
  - The ORRI and NPI owners argued that the property of the estate exclusion for production payments provided by 11 U.S.C. §541(b)(4) would apply; and
  - They argued the underlying OCS lease was an immovable, and therefore the carved out ORRI's and NPI's were immovable rights under Louisiana law as surrogate federal law and therefore not property of the ATP bankruptcy estate
- Why important?

ATP Adversary Proceedings

- Interior adopted some of ATP's arguments
- Generally, ATP and Interior argued that OCS leases were both unexpired leases of non-residential real property and executory contracts under the Bankruptcy Code
  - ATP and Interior argued that Louisiana law cannot apply as surrogate federal law under OCSLA because Louisiana law is inconsistent with federal law – that OCS leasehold interest and other mineral rights on the OCS are merely contractual/ personal rights under the Bankruptcy Code
  - ATP and Interior also argued that 11 U.S.C. §365 governs OCS leases because they are both executory contracts and unexpired leases
  - ATP and Interior also argued that the NPI and ORRI were disguised financings not "true sales"

ATP Adversary Proceedings

- The USBC for the SDTX has made only one substantive ruling in relation to this dispute
- "This motion for summary judgment relates to whether certain prepetition transactions between ATP and NGP Capital were real property conveyances (as they are characterized in the respective documents) or were actually debt instruments."
- The USBC for the SDTX denied the motion for summary judgment filed by the NPI and ORRI holders, finding that there is a question of fact as to whether the NPI and ORRI conveyances were disguised financings or not
- The USBC for the SDTX did not directly address whether or not OCSLA mandated that Louisiana law apply to the dispute as surrogate federal law, but by implication that may be the case since all analysis considered Louisiana law
- The USBC for the SDTX also did not directly address whether there is federal law governing the nature of the property interests in dispute, whether under the Bankruptcy Code or otherwise, thereby side-stepping an ultimate decision on the OCSLA issue for the time being

Recent ATP Filings

- On May 27, 2016, a number of lien claimants complicated the issues by filing interventions in certain of the pending ATP Adversary Proceedings
- The lien claimants "seek a declaration that the [term NPI and ORRI] are not property of the Debtor's estate nor executory contracts or leases which the Debtor may reject under 11 USC §365 . . . and that the Subject Interests were assigned to the [NPI/ORRI Holders] after the lien inception date of [their] statutory liens."
- The lien claimants argue that their liens attached to the interests carved out of ATP's OCS leases in favor of the NPI/ORRI Holders and their liens affect the hydrocarbons associated with the NPI's and ORRI's and proceeds therefrom

Additional Thoughts

- Clearly, this litigation and the nuances associated therewith are not winding down
- Lien ranking in relation to NPI and ORRI carve outs create interesting issues
- Interior's argument may allow lessees to cherry pick their OCS leases; they can reject the non-economic leases and assume the productive leases since Interior argues 11 USC §365 controls
  - But Midlantic v. New Jersey Dept. of Environ. Protection, 474 U.S. 494 (1986) and related jurisprudence may still apply
  - May leave decommissioning liabilities to co-liable parties
  - This new philosophy is contrary to prior experience with Interior on these issues in several bankruptcies before ATP
  - Interior's argument that OCSLA utilizes the word "lease" can be countered by the fact that the Louisiana Mineral Code also utilizes the word "lease," but unequivocally classifies it as an immovable property interest
- Issues associated with the interplay of OCSLA and the Bankruptcy Code are only now being identified

Regulatory Issues with Enhanced Focus on Decommissioning and Financial Assurance

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Regulatory
Decommissioning Liabilities

- **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

Regulatory Decommissioning Liabilities

- **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.

Regulatory Decommissioning Liabilities

- Debtors will argue that accrual of decommissioning liabilities occurs when the infrastructure is created controls and that decommissioning liabilities are pre-petition, unsecured claims
- Interior will counter with argument that the obligation subsists until "each obligation is met," which may mean that decommissioning coming due during the pendency of a bankruptcy case will make it an administrative expense claim
- Interior will also rely upon specific jurisprudence:
  - Midlantic v. New Jersey Dept. of Environ. Protection, 474 U.S. 494 (1986)
  - In re HLS Energy Co., 151 F.3d 434 (5th Cir. 1998)
  - In re American Coastal Energy, Inc., 399 B.R. 805 (Bankr. S.D. Tex. 2009)

Regulatory Decommissioning Liabilities

- There are additional questions surrounding "accrual" and "until each obligation is met"
  - 30 CFR 250.1710 mandates that wells be plugged within 1 year after the applicable lease terminates
  - 30 CFR 250.1725 mandates that platforms and other facilities be removed within 1 year after the applicable lease or right-of-way terminates
- Does this mean that the 1 year period is only important if occurring during a bankruptcy?
- What if the 1 year expired before the bankruptcy petition date?
- What if a bankrupt company's OCS leases have 10 more years of productive life?
- Are certain decommissioning claims contingent claims?
- These issues are ripe for further jurisprudential development

Regulatory Decommissioning Liabilities Predecessor Issues

- **Subpart G 30 CFR 556.700, et seq. – May I assign or sublease all or any part of the record title interest in my lease? (formerly 30 CFR 556.62)**
  - **This section explains how to assign record title and other interests in OCS oil and gas or Sulphur leases.**
- **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.**

Regulatory Decommissioning Liabilities Predecessor Issues

- **30 CFR 556.711 – What is the effect of a record title holder's sublease of operating rights on the record title holder's liability? (formerly 30 CFR 556.64)**
  - **(a) A record title holder who subleases operating rights remains liable for all obligations of the lease, including those obligations accruing after BOEM's approval of the sublease…(b) Neither the sublease of operating rights, nor subsequent assignment of those rights by the original sublessee, nor by any subsequent assignee of the operating rights, alters in any manner the liability of the record title holder for nonmonetary obligations.**

28 U.S.C. §959 and Midlantic

- 28 U.S.C. §959 requires debtors to comply with the laws applicable to where their properties are situated
- Midlantic Nat'l Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494, 507, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986)
  - ". . .we hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."
  - Midlantic consistently applied to OCS leases and liabilities
- 28 U.S.C. §959 and Midlantic principles affect how debtors and other parties in interest handle decommissioning liabilities in bankruptcy proceedings

Specific Decommissioning Jurisprudence

- **In re H.L.S. Energy Co., 151 F.3d 434 (5th Cir. 1998)**
  - **"A Bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety. And there is not question that under Texas law, the owner of an operating interest is required to plug wells that have remained unproductive for a year."**
  - **"Under federal law, bankruptcy trustees must comply with state law. *See* 28 U.S.C. § 959(b). Furthermore, a bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety," citing Midlantic.**
  - **Decommissioning is an "actual and necessary" cost of administering the estate, and are therefore administrative expense claims.**

Specific Decommissioning Jurisprudence

- In re American Coastal Energy, Inc., 399 B.R. 805 (Bankr. S.D. Tex. 2009)
  - Debtor contended that decommissioning claims are not administrative expense claims because only post-petition liabilities qualify as administrative expenses under 11 U.S.C. §503(b)(1)(A)
  - USBC for the SDTX disagreed; decommissioning costs are administrative expenses and do not fit within the same framework as trade-creditor claims arising from pre-petition liabilities
  - "Under § 959 and Midlantic, American Coastal's obligation to plug the wells in accordance with Texas law is a continuing post-petition obligation. American Coastal's continuing post-petition duty to conform with Texas law renders expenditures necessary to conform with that law actual and necessary costs of preserving the estate entitled to § 503(b)(1)(a) administrative priority."

Regulatory Decommissioning Liabilities Predecessor Issues

- In re Anadarko Petroleum Corporation, 187 IBLA 77, decided February 12, 2015
  - BSEE ordered Anadarko to perform decommissioning without also ordering other predecessors in the chain of title of ATP
  - Anadarko argued that BSEE had to move sequentially up the chain and not start with it
  - IBLA ruled that BSEE was within its regulatory rights to order Anadarko to perform the decommissioning

Regulatory Decommissioning Liabilities Predecessor Issues

- **Anadarko and Gomez Property in ATP**
  - **Anadarko objected to the sale of ATP's producing properties to Bennu because it would deprive the estate of resources to perform decommissioning associated with non-sale properties, which were being abandoned**
  - **Anadarko invoked Midlantic principles**
  - **Anadarko argues that abandonment of Gomez would violate Midlantic and applicable decommissioning regulations which are "reasonably designed to protect the public health and safety from identified hazards."**

Regulatory Decommissioning Liabilities Predecessor Issues

- **In re ATP Oil & Gas Corporation, 2013 WL 3157549 (June 19, 2013)**
  - **In a published decision, USBC for the SDTX ruled that BSEE could look to Anadarko as predecessor for the Gomez Property to decommission as a means to protect the public health and safety as required by Midlantic**
  - **Judge Isgur held:**

    "Anadarko would have Midlantic expanded well beyond its facts and law. . . . [Midlantic] did not hold that property posing a risk to public health and safety may never be abandoned. It certainly did not hold that such property may not be abandoned where abandonment would be consistent with (and perhaps in furtherance of) an environmental regulatory scheme."

    "The principle underlying *Midlantic* is that a bankruptcy court should not allow abandonment where it would be in derogation of laws reasonably designed to protect the public's health and safety. The Court believes that it would potentially *violate Midlantic* by requiring ATP to retain the Gomez Properties when the United States has chosen an alternate course of action to protect the public health and safety."

Regulatory Decommissioning Liabilities Predecessor Issues

- In re ATP Oil & Gas Corporation, 2013 WL 3157549 (June 19, 2013)

- Judge Isgur further held:

  "The Court is not unsympathetic to Anadarko. It may be forced to bear a substantial cost as a result of ATP's financial woes. Nevertheless, like many things in a bankruptcy case, the cost that Anadarko may bear is a reflection of the credit risk it took. Anadarko sold a portion of the Gomez Properties to ATP, and required ATP to bear the financial burden of plugging and abandonment in accordance with applicable federal law. This unfortunate position is no different from that of any other creditor that relies on the promise of performance from an eventually failed entity."

- This case clearly applied the BSEE decommissioning regulations in the context of an OCS lease/liability abandonment scenario

Regulatory Decommissioning Liabilities Predecessor Issues

- Co-liable parties may only have contingent claims until decommissioning actually completed and paid for by co-liable parties
  - In Re Tri-Union Development Corp., 314 B.R. 611 (Bankr. S.D. Tex. 2004)
    - Contingent claims for decommissioning of sureties, co-lessees, and predecessors are disallowed under 11 U.S.C. §502 until they are actually paid
    - Did not decide whether such claims were entitled to administrative expense priority while still in contingent stage
- What happens if Interior is granted an administrative expense claim and the predecessors in interest are not?

Regulatory Decommissioning Liabilities Predecessor Issues

- Co-liable parties may have subrogation rights through BOEM/BSEE regulations after they perform decommissioning, even to administrative expense claim status
  - In Re Tri-Union Development Corp., 314 B.R. 611 (Bankr. S.D. Tex. 2004)
  - In re ATP Oil & Gas Corporation, 2013 WL 3157567

    "The Court has previously held that a party paying decommissioning costs may be subrogated to the economic rights of the United States . . .. As to whether Anadarko can prevail on such a claim is well beyond the purview of the present dispute. However, if it is subrogated to the economic rights of the United States, Anadarko may be entitled to enforce an administrative claim for the costs of the cleanup."
- What happens if Interior is granted an administrative expense claim and the predecessors in interest are not?
- But see Fruge v. Parker Drilling Co., 337 F.3d 558 (5th Cir. 2008) ("The regulations govern the parties' joint and several liabilities vis-à-vis the Government, not amongst themselves.")

Current BOEM Bonding Guidelines

- **Start with general lease surety bonds - 30 CFR 556.900 et seq. (formerly 30 CFR 556.52 et seq.)**
  - **Covers all types of lease obligations**
  - **Extends beyond the end of lease (i.e. tail)**
  - **Required by all lessees (no waivers)**
  - **Lease-specific or area-wide bond amount based on lease activity:**

Lease Activity	Lease Specific Bond Amount	Area-Wide Bond
No approved operational activity	$50,000	$300,000
Exploration Plan	$200,000	$1,000,000
Development Production Plan	$500,000	$3,000,000
Pipeline - ROW	N/A	$300,000

Current BOEM Bonding Guidelines

- **Supplemental Bonds - 30 CFR 556.901 (formerly 30 CFR 556.53(d)**
  - **Provides additional coverage for all types of lease obligations**
  - **Cancelled after decommissioning completed/certified by BSEE and ONRR's clearance for outstanding payments**
  - **Regional Director currently sets the bond amount on a lease, ROW and RUE basis consistent with the BSEE decommissioning assessments**

Upcoming Changes to Financial Assurance Requirements

- ATP and Macondo have created concern relating to the adequacy of financial assurance under current regulations and NTL 2008-N07
- BSEE has systematically reassessed almost all leases, ROWs and RUEs in the past two years; new assessments are expected in August 2016
- BOEM is in the process of replacing NTL 2008-N07 with an updated Notice to Lessees, which will effectively eliminate the concept of exemptions/waivers from supplemental bonding, thereby mandating the provision of financial assurance from several additional lessees operating on the OCS (< $30 billion)
- Companies will have to prepare, present, and then negotiate tailored plans associated with providing adequate financial assurance consistent with the new NTL

Priorities Relating to Financial Assurance under New NTL

- Sole uncovered properties
  - Inactive (relinquished, terminated or expired) properties
  - Active (not relinquished, not terminated or not expired) properties
- Properties with no active co-lessees (may have predecessors)
  - Inactive properties
  - Active properties
- Properties with active co-lessees
  - Inactive properties
  - Active properties

Implementation of New NTL

- It is expected that companies will present to BOEM "Tailored Plans" relating to financial assurance
- It is expected that the priority of liabilities should be addressed in order
- Financial assurance was provided through decommissioning trust agreements in ATP bankruptcy somewhat consistent with this list of priorities
- Helpful if bankrupt entities include decommissioning in their DIP financing budgets
  - ATP
  - Black Elk

New NTL In Bankruptcy Proceedings

- There will be a heightened focus on financial assurance tender and maintenance thereof during the pendency of bankruptcy proceedings
- 28 USC §959 requires trustees and debtors-in-possession to comply with State laws and arguably applies to financial assurance obligations

Other Regulatory Considerations

- Idle Iron decommissioning
- HSE included in DIP budget
- Reservation of rights by BOEM/BSEE in relation to co-lessees and predecessors in interest

So, what's the point?

- 28 USC §959 mandates that trustees and debtors-in-possession must comply with applicable law
- Generally, this will require trustees and debtors in possession to comply with decommissioning, bonding, and all financial assurance requirements and regulations of BOEM and BSEE during the pendency of the bankruptcy case
- The costs of these requirements may drain the estate to the detriment of other creditors and parties in interest

Lease Maintenance
&
the Automatic Stay

OCS Lease Maintenance Generally

- 30 C.F.R 250.180(b) - lease will expire if you stop conducting operations for 180 consecutive days unless operations resumed or a suspension of operations or a suspension of production is granted
- Operations include drilling, well-reworking, and production in paying quantities

SOO/SOP Generally

- **30 CFR 250.168**

  May operations or production be suspended?

  (a) You may request approval of a suspension, or the Regional Supervisor may direct a suspension (Directed Suspension), for all or any part of a lease or unit area.

  (b) Depending on the nature of the suspended activity, suspensions are labeled either Suspensions of Operations (SOO) or Suspensions of Production (SOP).

Suspensions Granted and Directed

- **30 CFR 250.172**

The Regional Supervisor may grant or direct an SOO or SOP under any of the following circumstances:

(a) When necessary to comply with judicial decrees prohibiting any activities or the permitting of those activities. The effective date of the suspension will be the effective date required by the action of the court;

(b) When activities pose a threat of serious, irreparable, or immediate harm or damage. This would include a threat to life (including fish and other aquatic life), property, any mineral deposit, or the marine, coastal, or human environment. BSEE may require you to do a site-specific study;

(c) When necessary for the installation of safety or environmental protection equipment;

(d) When necessary to carry out the requirements of NEPA or to conduct an environmental analysis; or

(e) When necessary to allow for inordinate delays encountered in obtaining required permits or consents, including administrative or judicial challenges or appeals.

Suspensions Granted and Directed

- **30 CFR 250.172**

  The Regional Supervisor may grant or direct an SOO or SOP under any of the following circumstances:

  > **(a) When necessary to comply with judicial decrees prohibiting any activities or the permitting of those activities. The effective date of the suspension will be the effective date required by the action of the court;**

- **This may be an important tool in relation to preserving leases in bankruptcy proceedings because it allows for court orders to be utilized to support an SOO or SOP**
- **We have used this provision to support maintenance of SOP's, albeit in non-bankruptcy scenarios**

Suspensions Granted and Directed

- 30 CFR 250.173 When may the Regional Supervisor direct an SOO or SOP?
- The Regional Supervisor may direct a suspension when:
  - (a) You failed to comply with an applicable law, regulation, order, or provision of a lease or permit; or
  - (b) The suspension is in the interest of National security or defense.
- These provisions may get into separation of powers issues, but are arguably applicable in bankruptcy cases

Interplay with Automatic Stay

- 11 U.S.C. §362
- Does this operate to preserve a debtor's rights in a lease even when traditional lease maintenance activities were not performed?
- What if a lease is classified as an executory contract or unexpired lease of non-residential real property under 11 USC §365?
- What if a lease is not classified as an executory contract or unexpired lease of non-residential real property under 11 USC §365?
- Issues will most likely pop up when Interior orders shut ins during a bankruptcy case pursuant to 30 CFR 250.173 for:
  - HSE Generally
  - Environmental Issues
  - Bonding and Financial Assurance

Recommendations Pertaining to Regulatory Rights

- Recommend that bankrupt oil and gas lessees on OCS strive to comply with all lease and regulatory obligations to maintain the effectiveness of their leases
- File SOO's and SOP's as appropriate in the ordinary course of business
- Solicit complimentary court orders to facilitate SOO's and SOP's when feasible
- File IBLA appeals as appropriate
- Initiate automatic stay litigation if circumstances require
- Maintain open dialogue and communications with BOEM and BSEE on all important issues

Issues with OCS Executory Contracts

LOOPER GOODWINE

Is a particular contract an Executory Contract or Unexpired Lease? 11 USC §365

- **What is an executory contract?**
  - **Bankruptcy Code does not define "executory contract"**
  - **Countryman Definition: a contract "under which the obligations of both the bankrupt and the other party … are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."**
  - **NLRB v. Bildisco & Bildisco, 465 U.S. 513, 104 S. Ct. 1188, 79 L.Ed. 482 (1984) "Congress intended the term to mean a contract on which performance is due to some extent on both sides."**
  - **The Fifth Circuit, covering Louisiana, Texas and Mississippi has adopted the Countryman definition. In re Murexco Petroleum, Inc., 15 F. 2d 60, 62-63 (5th Cir. 1994), n. 8.**
  - **In re Bradlees Stores, Inc., 2001 WL 1112308 at *7 (S.D.N.Y Sept. 20, 2001): Under Countryman Test, a contract is executory if failure of the parties to perform the obligations remaining due would constitute a material breach of the agreement. Look to state law for what constitutes a breach.**

Assumption v. Rejection

- **Effects of assumption**

  Stewart Title v. Old Republic National Title Insurance Co., 83 F. 3d 735, 741 (5th Cir. 1996)

  - **Cure all defaults**
  - **Provide compensation**
  - **Provide adequate assurance of future performance**

- **Must assume a contract before it can be assigned**
- **Same requirements for assumption apply if the executory contract will be assumed and then assigned, but credit worthiness of assignee may demonstrate adequate assurance of future performance**

Assumption v. Rejection

- **Effects of rejection**

  NLRB v. Bildisco & Bildisco, 682 F. 2d 72, 79 (3rd Cir. 1982), aff'd., 465 U.S. 513 (1984)

  - **Business Judgment Test**
  - **Rejection Damages**
    - **Usually pre-petition unsecured claims**

Rejection
Business Judgment Test

- Would a reasonable business person make a similar decision under similar circumstances?
- Was the Debtor's decision a product of bad faith, whim or caprice or an otherwise unreasonable exercise of its business judgment?
  - Orion Pictures Corp. v. Showtime Networks, 4 F. 3d 1095, 1098 (2d. Cir. 1993) – defers to debtor's determination if rejection of executory contract is advantageous
  - In re The Great Atlantic & Pacific Tea Co., 544 B.R. 43 (Bankr. S.D.N.Y. 2016) – bankruptcy court places itself in position of the debtor in possession and determines whether assuming or reject contract would be a good business decision or a bad one

Executory Contracts Most Important to OCS Oil and Gas Bankruptcies

- Mineral Leases
- Purchase and Sale Agreements
- Farmout Agreements
- Production Handling Agreements
- Joint Operating Agreements
- Midstream Contracts

Mineral Leases

- ATP Adversary Proceeding Summary Regarding OCS Leases Discussed Previously
- Non-OCS Cases:
  - Texaco v. Louisiana Land and Exploration Co., 136 B.R. 658 (M.D. La. 1992)
  - In re WRT Energy Corp., 202 B.R. 579 (Bankr. W.D. La. 1996)
  - In re Heston, 69 B.R. 34 (N.D. Okla. 1986)
  - In re Topco, Inc., 894 F. 2d 727 (5th Circuit. 1990)
  - In re Delta Energy Resources, Inc. v. Damson Oil Corporation, 72 B.R. 7 (W.D. La. 1985)
  - In re Ham Consulting Company/William Lagnion/JV, 143 B.R. 71 (Bankr. W.D. La. 1992)

Purchase and Sale and Related Agreements

- In re Murexco Petroleum Corp., 15 F. 3d 60 (5th Cir. 1994)
  - Held APA not an executory contract because all conditions precedent to closing occurred
- What about asset exchange agreements?
- Not all PSA's are the same; some have Seller continuing obligations which would make APA/PSA executory
- Can PSA's change their nature from executory to non-executory depending on timing and circumstances?

Farmout Agreements

- **Bankruptcy Code defines "Farmout Agreement" in 11 U.S.C. §101(21A) as an agreement where:**

  "(A) The owner of a right to drill, produce, or operate liquid or gaseous hydrocarbons on property agrees or has agreed to transfer or assign all or part of such right to another entity; and

  (B) Such other entity (either directly or through its agents or its assigns) as consideration agrees to perform drilling, reworking, recompleting, testing, or similar or related operations to develop or produce liquid of gaseous hydrocarbons on the property."

Farmout Agreements

- 11 U.S.C. § 541(b)(4) (Property of the Estate Issue)
- Property of the estate does not include . . . any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—
  - (A) (i) the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement; and
    - (ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544(a)(3) of this title; or
  - (B) (i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and
    - (ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 542 of this title;
- This analysis applies when the Debtor is the Farmor and is designed to protect the non-debtor Farmee

Farmout Agreements

- What happens when the Farmee is the bankrupt Debtor?
- This situation is not a property of the estate issue; it is a straight up §365 assumption/rejection issue
- Do you want a bankrupt Debtor as Farmee to be conducting drilling operations on your lease when your company is liable for the liabilities being created?
- This becomes an assumption/rejection issue under 11 USC §365
- Get adequate assurance of future performance through bonds or financial assurance to protect against liabilities!!!

Production Handling Agreements

- In re Panaco, Inc. (Case No. 02-37811) (USBC SDTX)
- Generally executory
- Real Life Example
  - Platform Owner's leverage as a bankruptcy entity
  - Satellite Well Owner's lack of leverage as a bankruptcy entity

Joint Operating Agreements

- In re Price, 71 B.R. 341 (Bankr. N.D. Okla. 1987) – Oil and gas operating agreements are a series of distinct obligations, not just one contract; thus, the court held that JOA's were not executory contracts.
- In re Wilson, 69 B.R. 960 (Bankr. N.D. Tex. 1987) – Both parties have continuing obligations under the operating agreements so long as oil and has are produced from the wells in questions; thus, the operating agreements are executory contract.
- Transtexas Gas Corp. v. Forcenergy Onshore, Inc., 2012 WL 1255218 (Tex.App. Corpus Christi)
- In re Panaco, Inc., 2002 WL 31990368 (Bankr. S.D. Tex.)
  - Mandated early assumption or rejection and forced Panaco to escrow for its eventual decommissioning obligations
- Most courts, without litigation proceeding to a published decision, treat JOA's as assumable contracts.

Midstream Contracts

- **In re Sabine Oil & Gas Corporation, Case No. 15-11835 (Bankr. SDNY): held that Debtor's decision to reject midstream agreements is reasonable exercise of business judgment**
  - **Gas gathering agreements and condensate gathering agreements = executory contracts**
  - **Debtor argued it is not financially viable to deliver minimum volumes of product under relevant Agreements**
  - **Absent rejection, would be required to make contractual deficiency payments, imposing considerable and unnecessary drain on the estates' resources**
  - **Plan to enter into new gathering agreements with other gatherers on terms more favorable to Debtors**
  - **Court recently made binding its decision that the midstream contracts did not "run with the land" and could be rejected**

Midstream Contracts

- In re Quicksilver Resources, Inc., Case No. 15-10585 (Bankr. Delaware)
- In re Energy & Exploration Partners, Inc., Case No. 15-44931 (N.D.T.X. Bankr.)
- In re Magnum Hunter Services Corp., Case No. 15-12533 (Bankr. Delaware)
- In re Emerald Oil, Inc., Case No. 1:16-bk-10704 (Bankr. Delaware)
  - Most recently filed adversary proceeding challenging whether midstream contracts "run with the land"
- No OCS cases pending at present on this issue
- Costs associated with replacing midstream infrastructure on OCS *may* keep this dispute on dry land

Increased Litigation Associated with Abandonment of Decommissioning Obligations

§554 Abandonment of property of the estate

- The trustee or the bankruptcy estate may abandon property so that the abandoned property's liabilities and responsibilities will vest in the Debtor entity with the bankruptcy estate relieved of these future burdens
- Ability to abandon property relying on the Bankruptcy Code **may** conflict with a well operator's statutory obligation to plug and shut-in wells when these wells stop producing
- Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494, 106 S. Ct. 755, 88 L.Ed.2d 859 (1986) - held that the abandonment power under the Bankruptcy Code is not unlimited and that a debtor cannot abandon property that would violate decommissioning regulations "reasonably design to protect the public health or safety from identified hazards."
- In re H.L.S. Energy Co., 151 F.3d 434 (5th Cir. 1998)
- In re American Coastal Energy, Inc., 399 B.R. 805 (Bankr. S.D. Tex. 2009)

ATP Sheds Residual Decommissioning Liabilities

- After filing for bankruptcy protection and a series of failed negotiations to continue operations, ATP shut-in certain OCS properties and moved to concurrently reject any unexpired leases related to certain properties and abandon any right or interest in those properties.
- ATP, as operator, was responsible for decommissioning all of the wells and facilities located on the certain properties.
- Under decommissioning regulations, DOI could look to ATP's predecessor in interest to satisfy decommissioning obligations (for wells and facilities in place when predecessor transferred its interest to ATP)
- Interior and ATP's predecessor in interest objected to abandonment
  - Argued that ATP cannot abandon environmental liabilities under Midlantic

ATP Sheds Residual Decommissioning Liabilities

- The court permitted abandonment in light of Midlantic
- "The principle underlying *Midlantic* is that a bankruptcy court should not allow abandonment where it would be in derogation of laws reasonably designed to protect the public's health and safety. The Court believes that it would potentially *violate Midlantic* by requiring ATP to retain the Gomez Properties when the United States has chosen an alternate course of action to protect the public health and safety."
- "The Court is not unsympathetic to ATP's predecessor in interest. It may be forced to bear a substantial cost as a result of ATP's financial woes. Nevertheless, like many things in a bankruptcy case, the cost that Anadarko may bear is a reflection of the credit risk it took. Anadarko sold a portion of the Gomez Properties to ATP, and required ATP to bear the financial burden of plugging and abandonment in accordance with applicable federal law. This unfortunate position is no different from that of any other creditor that relies on the promise of performance from an eventually failed entity." In re ATP Oil & Gas Corp., 2013 WL 3157567, (Bankr. S.D. Tex. June 19, 2013)

Abandonment in Other Bankruptcies

- In re Allied Natural Gas Corporation, 99-33127 (USBC SDTX)
  - Included an "un-abandonment" concept
- In re Cronus Offshore, Inc., 05-36492 (USBC-SDTX)
- In re Matagorda Island Gas Operations, LLC, 14-51099 (USBC WDLA)
- In re Tri-Union Development Corporation, 03-44908 (USBC SDTX)
- In re Virgin Oil Company, 09-11899 (USBC EDLA)
- Others

Working Interest Partner Issues

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Working Interest Partner Issues

- Operators make advances on behalf of non-operators; bankruptcy of non-operator gives rise to prepetition claims for capital expenditures and LOE advanced by operator on non-operator's behalf
- Operators sometimes market production for non-operators; non-operators take credit risk of operator until they are paid from the proceeds of the production; bankruptcy of operator gives rise to claims by non-operator for hydrocarbons produced and sold prepetition
- AFE's and Cash Calls/Consent and Non-Consent Operations
- Property of estate issues may be impacted

Security Rights

- Reciprocal Grants of Security Interests in Operating Agreements
- Louisiana Operator/Non-Operator Lien Act (LSA-R.S. 9:4881, et seq.
- Interplay with mortgage subordinations and public records doctrine
  - Mortgages often include subordination clauses for operating agreement liens and other obligations
  - Grace-Cajun Oil Co. v FDIC, 882 F. 2d 1008 (5th Circuit 1989)
    - Mortgagees cannot assert rights superior to those of their mortgagors
    - Delta had to pay its share of expenses to participate in proceeds of production; therefore, its mortgagee also had to participate in payment of expenses
    - "When Mbank exercised its rights under the Collateral Mortgage and Assignment of Production, it became obligated to pay Delta's proportionate share of the drilling and completion costs before sharing in the proceeds."
    - "By paying Delta's share of the well costs, Grace-Cajun acquired a 'right of prior claim' to the proceeds allocable to Delta's interest until those costs were recouped."
  - In re Century Offshore Management Corporation, 119 F.3d 409 (3d Cir. 1997)
    - The mortgage was made subject to the applicable operating agreement, and therefore non-operators' unperfected liens under the operating agreement ranked ahead of the perfected mortgage interest

Set-Off and Recoupment

- **11 USC §553 (Set Off)**
  - Generally, "this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before commencement of the case . . ."
  - Pre-petition mutual debts can be offset; suggest court permission to confirm
- **In re United States Abatement Corporation, 79 F.3d 393 (5th Cir. 1996)**
  - Dealt with Mobil's "recoupment" against the Bankrupt Contractor for payments to subcontractor lien claimants
  - Mobil sought to pay the lien claimants directly and then recoup such payments from what it owed the Debtor
  - "In the bankruptcy context, the doctrine of recoupment has 'evolved to permit a creditor to offset a claim that arises from the same transaction as the debtor's claim.' . . . The doctrine operates 'as an exception to the rule that all unsecured creditors of a bankrupt stand on equal footing for satisfaction [and] . . . Sometimes allows particular creditors preference over others.'"
  - Claims must arise from the "same transaction"
  - "The justification for the recoupment doctrine is that where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor. . . . We have held that the trustee of a bankruptcy estate takes the property subject to the rights of recoupment. In other words, to the extent that a party is entitled to recoupment of funds, the debtor has no interest in the funds."

Consents to Assign

- Consents to assign (or anti-alienation provisions) are unenforceable in bankruptcy. 11 USC §365(f)
- Debtor has power to assume and assign an operating agreement (executory contract) over objection of non-operating joint interest owners even if, but for the bankruptcy, consent of the non-operator would have been required
- Interplay with preferential rights to purchase and disposition of leasehold interests

Waiting for debtor to decide whether to assume or reject

- Non-debtor must continue to perform before assumption or rejection
  - NLRB v. Bildisco & Bildisco, 465 U.S. 513, 532 (1984)
- Non-debtor bears risk and uncertainty from not knowing whether contract will be rejected, assumed, or assumed and assigned
- Non-debtor can reduce this uncertainty by seeking to shorten the time period for debtor to assume or reject to protect its interests
  - 11 U.S.C. § 365(d)(2)
  - Texas Importing Co. v. Banco Popular de Puerto Rico, 360 F.2d 582, 583 (5th Cir. 1966)

Additional Partner Bankruptcy Litigation Issues

- **Contract Claims against predecessors**
- **Parties to operating agreements may remain liable for defaults of their assignees by contract language or jurisprudence**
- **Example of operating agreement language:**

  The assignment of any such interest *shall not relieve the assignor making such assignment of any responsibility or liability* hereunder *accruing on or prior to the execution, delivery and approval by lessor, if required, of such assignment* unless consented to in writing by all of the parties then owning and holding interests in said leases, permits and areas.

  Should any party hereto sell its entire interest in the leases, permits and areas, then the party so disposing of its interest *shall be relieved of all obligations* hereunder *which accrue subsequent to the date of the delivery* to the purchaser of written assignment or conveyance of such interest, approved by lessor, if such approval is required, provided that the party disposing of its entire interest has fully paid its share of all costs incurred or accrued hereunder to the time of such sale.

Additional Partner Bankruptcy Litigation Issues

- **Jurisprudence to be used if no specific contract language to enforce liabilities against predecessors under operating agreements:**
  - **GOM Shelf, LLC v. Sun Operating Limited Partnership, et al., 2008 WL 901482 (S.D. Tex. 2008)**
  - **Seagull Energy E&P, Inc. v. Eland Energy, Inc., 207 S.W.3d 342 (Tex. 2006)**
  - **Chieftain International (U.S.), Inc. v. Southeast Offshore, Inc., 553 F.3d 817 (5th Cir. 2008)**

Additional Partner Bankruptcy Litigation Issues

- Payment of LOE pre- and post-petition and offset
- P&A Reserves and Escrows (In re Panaco)
- Application of Operating Agreement or State Law of Joint Ownership/Joint Tenancy?
  - Which is better?
- Pre-payments and Cash Calls
- Bonding and Financial Assurance
- Security rights and ranking
- Consent/Non-Consent Operational Issues

Offshore Oil & Gas Bankruptcy Issues

OCS Summer Seminar
Anadarko Tower

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