

# Oil & Gas Bankruptcy For State Regulators

Interstate Oil and Gas Compact Commission

5/16/2016

Presented by:

Patrick L. Hughes

*haynesboone*

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*Capitalism without bankruptcy is  
like Christianity without hell*

Frank Frederick Borman, II  
Retired U.S. Air Force Pilot, Commander of Apollo 8

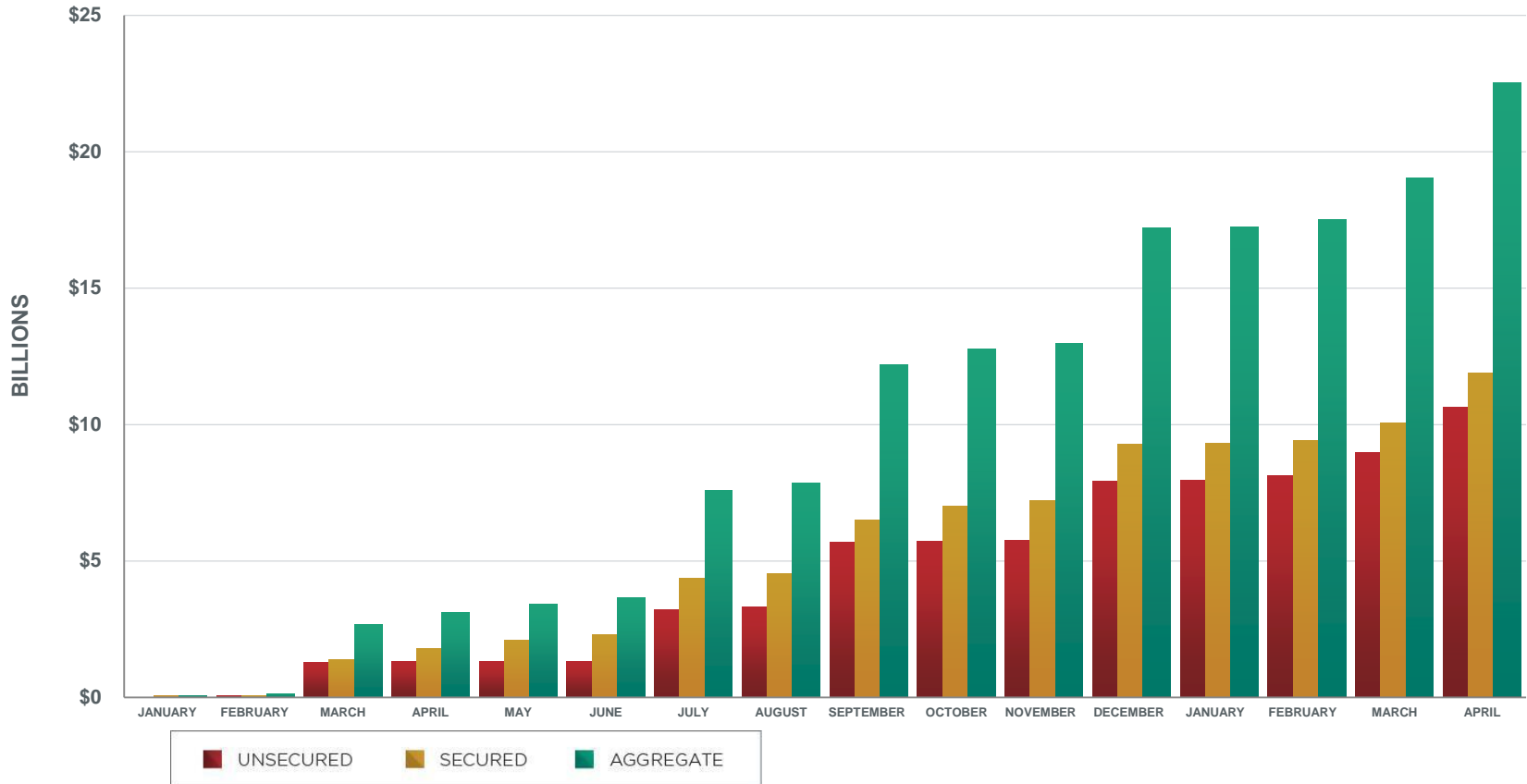
# Trends in Oil & Gas Bankruptcy Filings: It's Just Bad Out There

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# Trends in Oil & Gas Bankruptcy Filings

2015-2016 CUMULATIVE E&P UNSECURED DEBT, SECURED DEBT AND AGGREGATE DEBT

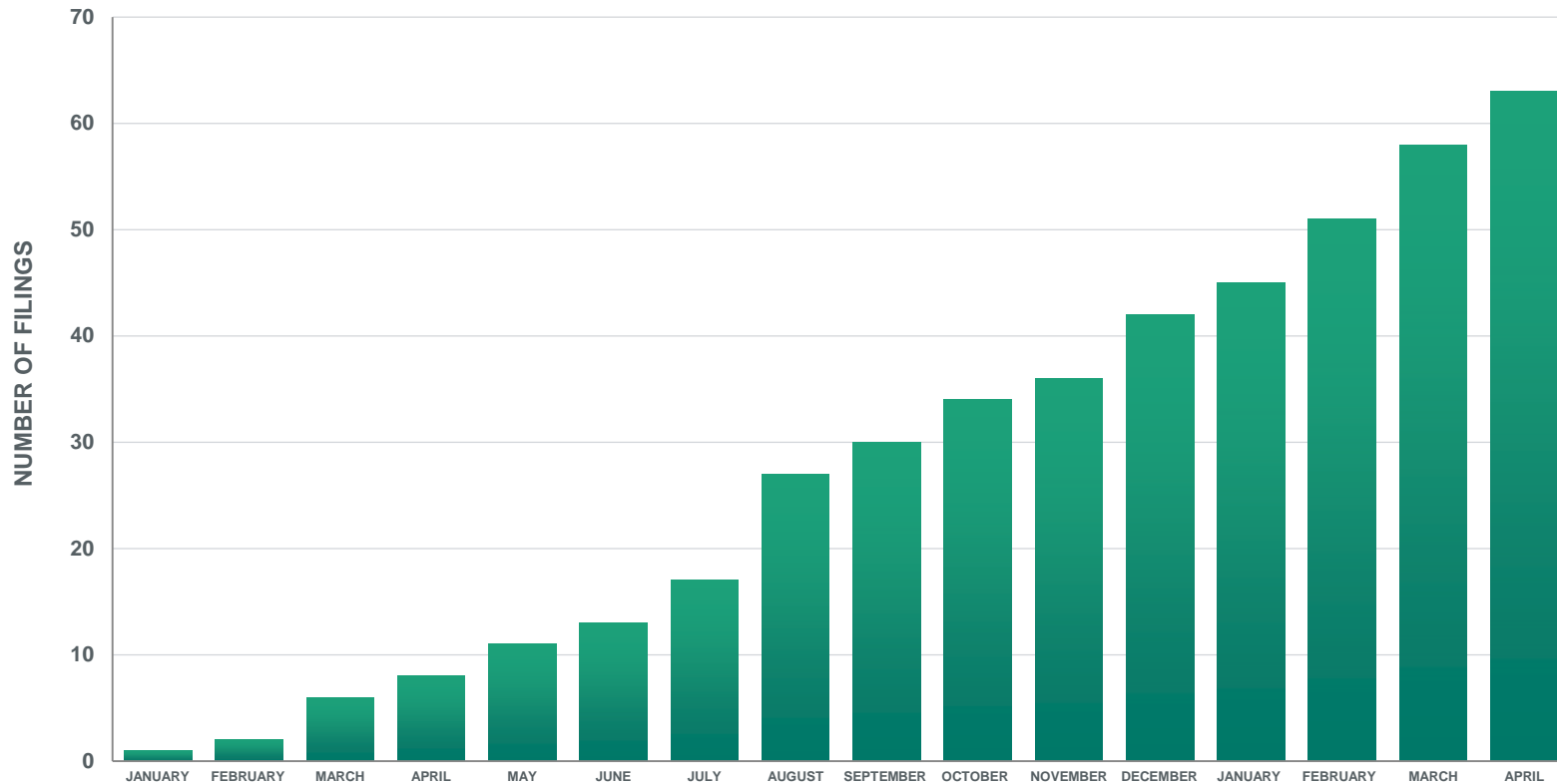
## HAYNES AND BOONE OIL PATCH BANKRUPTCY MONITOR



# Trends in Oil & Gas Bankruptcy Filings

2015-2016 CUMULATIVE NORTH AMERICAN E&P BANKRUPTCY FILINGS

## HAYNES AND BOONE OIL PATCH BANKRUPTCY MONITOR



# Why Oil & Gas Producers File Bankruptcy

- Low liquidity
- Obtain stay of remedies to buy time
- Drill their way out? [Not yet]
- To wipe out junior “out of the money” interests
- To reset payment terms
- To overcome holdout creditors



# Trends Toward Distress

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- Growing consensus that commodity prices will stay low for some time
- Bank regulators are pressuring senior energy lenders to redline large parts of their loan portfolio, requiring much larger bank reserves and rendering these loans unprofitable
- Risk of borrowing base reduction triggering extraordinary pre-emptive draw requests by borrowers and subsequent mandatory pays
- Expect rate of bankruptcy filings by E&P companies to remain steady or increase in 2016

# Bankruptcy Basics: Things Happen Quickly

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# Claims and the Petition Date

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## Pre-Petition Claims

- Frozen as of Petition Date
- Not Paid during Case\*
- Restructured and Paid under Plan

## Post-Petition Claims

- Kept Current during Case
- Ordinary Course Obligations
- Administrative Expenses



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Bankruptcy Filed  
“Petition Date”

*\* Unless permission granted by Court. Frequently granted for certain oil and gas-related claims (royalty, working interests).*

# Immediate Effect of Bankruptcy on Liens and Claims

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- Automatic Stay
  - Section 362
  - Prohibits Creation Liens Post-Petition\* or Enforcement of Pre-Petition Liens
  - Relief from Automatic Stay May Be Available
- DIP Loans
  - Section 364
  - Superpriority Lending
- Cash Collateral
  - Section 363
  - Consent or Court Authorization
- Adequate Protection
  - Diminution in Value
  - Valuation Date

\*Except M&M

# Due Process But Things Happen Quickly

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- First Day Orders
- Financing Orders – Beware of “DIPs”
- Bar Dates and Proofs of Claim
- Deadlines

# Transparency Should be Present

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- SOFA
- Schedules
- MORs
- Fiduciary Duties
- Rule 2004

# Cooperation v. Litigation

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- Adversarial Process
- Motion practice
- FRE and FRBP Apply
- Business Judgment Rule
- Kill the Goose?

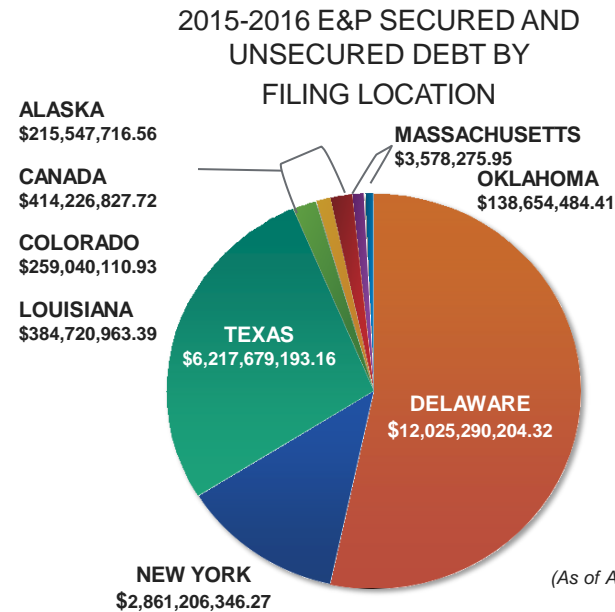
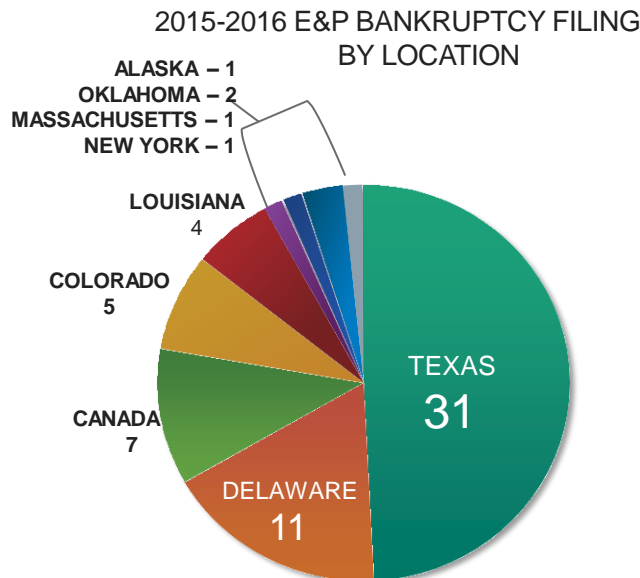
# Exit Strategies

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- Plan of Reorganization
  - Classification and Treatment of Claims
  - Reorganized Debtor Continues Operating Post-confirmation
  - Exit Financing
- Section 363 Sale of Assets
  - Assets Sold to Highest Bidder
  - Sale of Assets Free and Clear of Liens
  - Litigation Trust Formed to Pursue Avoidance Actions for Benefit of Creditors
  - Debtor Ceases Operations and Liquidates
- Conversion to Chapter 7
  - Debtor Unable to Pay Administrative Claims to Confirm Plan
  - Chapter 7 Trustee Appointed
  - Debtor Ceases Operations; Trustee Liquidates Assets and Distributes Proceeds to Creditors

# Venue

- Proper Venue: 28 U.S.C. 1408
  - Domicile, residence, principal place of business, or principal place of assets
  - Corporations
    - Domicile=place of incorporation
    - Principle place of business=“nerve center” where officers direct, control, and coordinate the corporation’s activities
  
- The “Delaware Effect”



(As of April 15, 2016)

# Interplay Between Bankruptcy & Regulation

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# State Regulatory Agencies

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- Colorado
  - Colorado Oil and Gas Conservation Commission (“COGCC”)
    - Enforces the Oil and Gas Conservation Act and promulgates rules necessary to carry out its provisions
      - Focus on promoting oil and gas production to include consideration of environmental impact and public health, safety, and welfare.
      - Authorized to regulate the drilling, producing, and plugging of wells, along with all other operations necessary for the production of oil or gas
  - Colorado Department of Public Health and Environment
    - Regulates enforcement hazardous materials and waste management, air pollution control, and water quality control

# State Regulatory Agencies

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- Texas
  - Texas Railroad Commission
    - Regulates the exploration, production, and transportation of oil and natural gas in Texas
  - Texas Commission on Environmental Quality (“TCEQ”)
    - Once an entity files for bankruptcy protection, the TCEQ must follow bankruptcy procedures and laws in order to recover and seek reimbursement.
    - Some agencies have found success reaching settlement agreements with debtors to ensure that environmental cleanup and restoration begins immediately.
    - The TCEQ handled an outstanding environmental liability it held against a debtor, American Smelting and Refining Company, to achieve its goal of cleaning up an environmentally contaminated site through a settlement agreement under Fed. R. Bankr. P. 9019.
    - But agencies must carefully consider the complete cleanup costs as the agency will be on the hook for any additional cleanup costs over and above the settlement amount.

# Enforcement Actions by the State

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- Excepted from the automatic stay if health, safety or welfare
  - Section 362(b)(4)
  - Motion seeking relief not required [but be mindful of contempt]
  - Action must be to further public safety and welfare or effectuate a public right
    - Imminent or identifiable harm not required, only that law designed to protect public from an identified hazard—*In re Am. Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009)
  - Injunctive relief only (e.g., cleanup order)
- Not excepted from the automatic stay
  - Action to collect monetary damages or seeking to seize control over property require court's permission
- Debtor may request the court to order a discretionary stay of enforcement proceedings
  - Section 105(a) grants the bankruptcy court power to “issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title”
  - Generally, courts will not stay enforcement actions under Section 105

# Environmental Compliance

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- 28 U.S.C. § 959
- Debtor under ongoing obligation post-petition to manage and operate property in accordance with state law
- State agencies can enforce statutes and regulations against debtor during bankruptcy

# Decommissioning/ Plugging and Abandonment Obligations

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- Debtor's abandonment power
  - Section 554
  - Property that is “burdensome” or of “inconsequential value and benefit” to estate
- Abandonment power is limited
  - *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Prot.*, 474 U.S. 494 (1986)
    - Bankruptcy Code does not trump state environmental laws
    - Debtor in possession or Trustee cannot abandon contaminated property in violation of a state statute “reasonably designed to protect the public health or safety from identified hazards.”
- Obligation to plug wells is a continuing post-petition obligation under section 959 and *Midlantic*
- Generally, can predecessors in interest can be liable for performance of decommissioning/P&A obligations if the debtor fails to perform?
- Statutes will determine rights

# Claims by the State

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- “Claim” distinguished from injunction
  - Claim—dischargeable through bankruptcy (e.g., reimbursement for cleanup costs or claims by the state for debtor’s prepetition violation of environmental laws)
  - Injunction—obligation passes through to reorganized debtor (e.g., cleanup order)
    - *United States v. Apex Oil Co.*, 579 F.3d 734, 738 (7th Cir. 2009)—cleanup order requiring debtor to spend \$150 million to remediate not dischargeable
- File a proof of claim
  - Contingent and unliquidated claims
  - Claim estimation may require expert testimony regarding remediation costs
  - *In re Buttes Gas & Oil Co.*, 182 B.R. 493 (Bankr. S.D. Tex. 1994)—Agencies may be able to file late claims to prevent environmental harms
- Unsecured, priority or administrative?

# Classification of Environmental Claims

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- Administrative expense—“actual, necessary costs of preserving the estate”
  - Costs associated with post-petition violation of law or injury to environment
  - Courts split whether costs associated with remediation of pre-petition contamination have administrative priority
  - *In re Am. Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009)
    - Postpetition expenses incurred by state to remediate the debtor’s prepetition environmental liabilities entitled to administrative priority
- Secured
  - Statutory liens
  - Section 506(c)—secured collateral can be charged for cleanup costs to preserve the property
- General unsecured
  - Penalties for pre-petition conduct
  - Pro rata distribution

# Dueling Liens?

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- **Environmental Liens can Have Priority?**
- Under Superfund and Texas' comparable statute, the Texas Solid Waste Disposal Act (“**SWDA**”), remediation costs incurred by the government give rise to a lien on the property remediated. Under Superfund and SWDA, environmental liens do not have priority over prior recorded liens, but in other states, such as Arkansas, Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, and Tennessee, a lien securing remediation costs is a “Superlien” that takes priority over prior recorded liens, including mortgages.
- In some states a lien may be imposed on both the property that is subject to remediation and on other real and personal property owned by the owner of the remediated property; however, such liens do not constitute “Superliens” and must be recorded.
- But can this impact credit access?



# Bonding and Co-Debtors

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- **Does the stay apply to stop action on co-debtors?**
- **Surety Bonds** Irrevocable surety bonds are often required to be issued for the benefit of the environmental authorities. These bonds serve as a backstop if the debtor fails to satisfy its environmental obligations. Because of the irrevocable nature of reclamation bonds and the fact that the bond obligates the surety to the environmental authorities (not the debtor), the status of a surety bond issued prepetition as an executory contract is subject to question. If the bond is an executory contract, then premiums due post-petition are administrative expenses. But, if the bond is not an executory contract, then such premiums are merely prepetition claims. Moreover, even if the bond is an executory contract, administrative expense status for post-petition premiums may still be subject to challenge because such obligations arguably do not arise as a result of a transaction with the debtor's estate. An irrevocable bond issued prepetition must be performed by the surety as a matter of law regardless of whether premiums are ultimately paid.

Questions?

haynesboone

*haynesboone*