

# Professional Landmen's Association of New Orleans

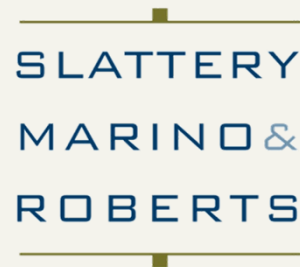
## Oil & Gas Seminar



Hilton New Orleans Riverside,  
New Orleans, LA 70140

# Oil & Gas Restructurings and Bankruptcies:

## OCS Considerations



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Low commodity prices and uncertainties in the market have challenged both oilfield service companies and E&P companies.

## PERFECT STORM CONDITIONS

- Reduced cash flow means less activity in E&P.
- Changes in financial responsibility requirements and increases in bonding amounts by regulators further threaten E&P companies.

- Industry lenders use reserve reports together with a company's track record to determine whether or not to make loans to independent oil and gas companies.
- In hard times, borrow base redeterminations dictate whether companies will have the resources to continue business operations.



- In other words, because reserves establish the borrowing base for most loans, borrowing base redeterminations curtail amounts of available cash to E&P
- Each lender makes its own determination of collateral value when adjusting borrowing bases.
- Low commodity prices = reduced borrowing bases as lender risk increases.

As income diminishes and borrowing bases shrink, we're beginning to see more and more defaults in loan facilities.

Add to the equation:

- Increases in financial responsibility to regulators and uncertainty regarding Notice to Lessees (NTL 2015-N04) and BOEM proposed Financial Assurance Criteria issued October 9, 2015
- vendor issues;
- customer issues; and
- threatened or actual litigation.

## Important to Remember:

- The commodity price must justify the cost of producing a barrel of oil.
- As of January 8, 2016, it was reported that there were 42 bankruptcy filings in 2015.
- Many of the energy-related chapter 11 filings have involved companies with primary fracking and conventional operations in the shale where upfront costs may be higher.
- Many of the companies that divested their OCS properties after regulatory changes following Macondo now face the perils of expensive onshore production together with the burdens of global overproduction and low commodity prices felt throughout the industry.



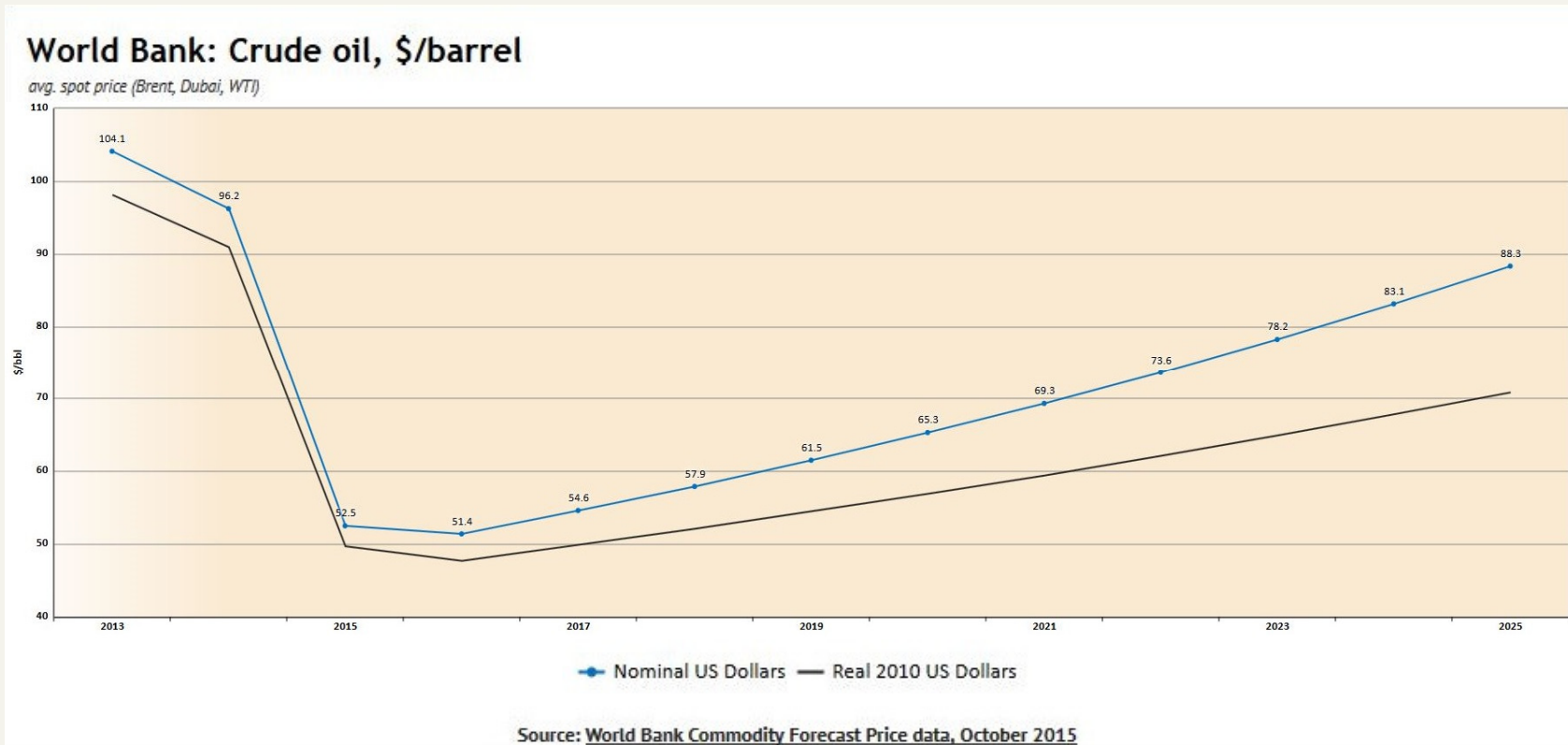


## Among The Largest Energy Related Chapter 11 Filings 2015

<u>Company</u>	<u>Outcome</u>
• WBH Energy LP (WDTX)	Sale
• CalDive International (DE)	Sale
• Dune Energy (WDTX)	Sale
• BPZ Resources (SDTX)	Sale
• Hercules Offshore (DE)	Sale
• Black Elk Offshore (SDTX)	Sale/Liquidation
• Miller Energy Resources (AK)	Reorganization
• RAAM Global Energy (SDTX)	Reorganization (not yet confirmed)
• Milagro Oil & Gas (DE)	Sale
• Sabine Oil & Gas (SDNY)	Reorganization
• Luca International Group (SDTX)	Sale
• Quicksilver Resources (DE)	Sale
• ERG Resources (NDTX)	Unsuccessful Sale/Reorganization
• Saratoga Resources (WDLA)	Reorganization
• Parallel Energy LP (DE)	Sale
• Samson Resources (DE)	Reorganization

# WHAT'S GOING ON IN THE MARKETS

Commodity prices may stay low for an extended period.



- If prices remain at historic lows, financial institution regulators will increase oversight of energy lenders and may force write downs of debt.
- E&P companies will look of alternative lenders such as private equity sources or look to second lien debt if available.

# SURVIVAL STRATEGIES

## Out-of-court options:

- Forbearance agreements
- Exchange offers
- Amendment of lending facilities/indentures
- Recapitalization, often with private equity partners

# LEGAL ALTERNATIVES

- Chapter 11
- Chapter 7
- Involuntary filings by creditors  
(Black Elk is an example of such an involuntary filing)
- State law remedies (injunctions, liens, litigation, receivers)

# WHY BANKRUPTCY: BENEFITS

- Chapter 11 gives the debtor/company a fresh start and the opportunity to perhaps reorganize as a leaner entity.



- Chapter 11 also provides temporary relief from creditors under the “automatic stay,” enjoining all collection activity.



Under chapter 11, all similarly situated creditors are treated equally pursuant to the bankruptcy equitable distribution provisions that establish priorities:

- Secured creditors get the value of their collateral (assuming sufficient assets)

- Unencumbered assets are distributed by priority:
- Administrative expenses are paid first;
- Entities with statutory priority are paid next (for example, the IRS);
- General unsecured creditors are next in line;
- Equity interests are paid last.

## Executory Contracts and Unexpired Leases

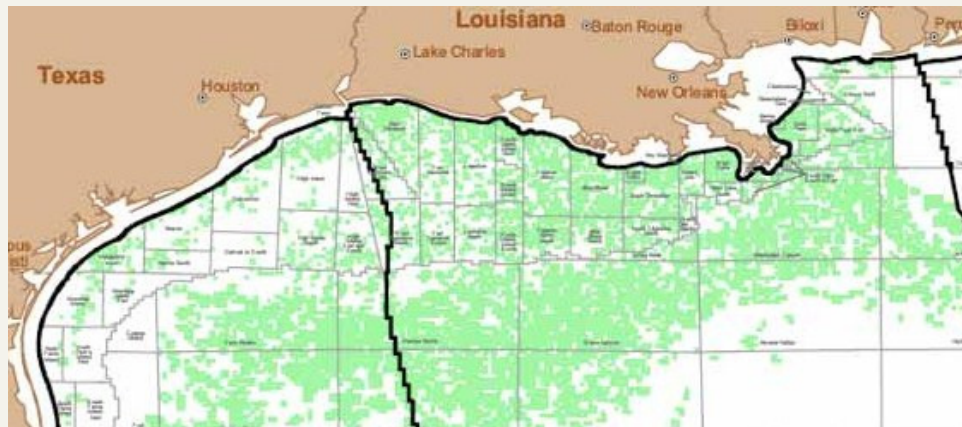
- An executory contract is “[a] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.”

- 11 U.S.C. § 365 entitles the debtor to assume or reject unexpired leases or contracts that are “executory”.
- Rejection results in breach of contract and may result in the interest reverting to the lessor.
- In *In re Pacific Energy Resources Ltd.*, Case No 09-10785 (Bankr. Delaware), the Debtor successfully abandoned Alaska state leases pursuant to Bankruptcy Code §§ 554 and 365.

- Assumption means that the debtor must cure the existing monetary defaults and provide adequate assurance of future performance.
- If the lease is considered a lease of real property under state law, then certain non-monetary faults need not be cured. 11 U.S.C. 365(b)(1)(A).

# SPECIAL OCS CONSIDERATIONS

- OCS leases are governed by federal law and are under federal control.
- The federal government is the original owner of the minerals and has the right to explore and produce the minerals.



- Federal courts have consistently held that federal BLM leases are real property interests.
- However, the question is unresolved regarding the nature of a property interest granted by an OCS lease.
- This issue became a central issue in the ATP bankruptcy. *In re ATP Oil & Gas Corp.*, 2013 WL 3157567 (Bankr. S.D. Texas. June 19, 2013)

- The Outer Continental Shelf Lands Act (OCSLA) applies adjoining state law unless federal law overrides state law. The federal law that overrides state law can be statutory or federal common law.
- Most OCS leases are located offshore Texas and Louisiana.
- Texas leases are real property interests, and the majority view holds that Louisiana leases are also real property interests



- The question of whether to apply the law of the adjoining state or an overriding federal law is made even more difficult because there is no federal statutory guidance regarding whether an OCS lease is a personal or real property interest.

- Although the leases are similar to federal land leases, the United States has taken the position in recent litigation that the leases are personal property rights that may be rejected.
- As of now, the issue of the nature of the property interests created by OCS leases (and their underlying royalties) is unresolved.

# Plugging and Abandonment

For OCS leases, federal law requires decommissioning when wells and related facilities are no longer useful for operations. Wells must be plugged and abandoned one year after lease termination and all equipment and facilities must be removed.



For parties in the chain-of-title, joint and several liability of lessees and owners of operating rights continues for current holders and predecessors-in-title.

# Oil and Gas Regulatory Requirements

Federal regulatory obligations have major impacts on buyers and sellers of oil and gas properties.

30 CFR §256.52 – surety bonds

Query: Can the abandonment or rejection power of a debtor be used to avoid oil and gas regulatory obligations?

- Courts generally have determined that a debtor's abandonment and rejection powers do not release or impinge upon regulatory obligations.
- Moreover, bankruptcy courts do not substitute their judgment for the judgment of a regulatory authority.

## **Abandonment Under Bankruptcy Code § 554**

- Under Bankruptcy Code § 554, 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.
- This ability to abandon property relying on the Bankruptcy Code may conflict with a well operator's statutory obligation to plug its shut-in wells when these wells stop producing.

- Plugging wells is costly, and even solvent companies as well as bankrupt entities with cash flow issues may have difficulty in funding these obligations.
- Thus, governmental entities and contractual partners require the posting of bonds that can only be released after wells are plugged or after the operator bonds or other financial security is posted.

- In bankruptcy, can the Debtor abandon?

Maybe sometimes: *In re ATP Oil & Gas Corp.*, 2013 WL 3157567 (Bankr. S.D. Texas. June 19, 2013).



- The United States Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 484 (1986), held that the abandonment power under the Bankruptcy Code is not unlimited and the estate may be barred from abandoning property and the related obligations if these obligations concern compliance with civil or criminal law:

“This exception to the abandonment power vested in the trustee by § 554 is a narrow one. It does not encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm.”

*Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 484, 495 (1986)

- The Fifth Circuit has addressed the estate's ability to abandon oil and gas property under *Midlantic*.
- In *In re H.L.S.*, the Fifth Circuit ruled on the issue of whether an estate could have abandoned wells with outstanding plugging liability. *Tex. v. Lowe (In re H.L.S Energy Co.)* 151 F.3d 434, 436 (5<sup>th</sup> Cir. Tex. 1998).

- The Fifth Circuit determined that "[a] bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety . . . under Texas law, the owner of an operating interest is required to plug wells that have remained unproductive for a year." *Id. at 438.*
- For the Fifth Circuit, no abandonment of property that had outstanding plugging liability was possible without addressing the question of whether there was a risk of imminent harm to the public.

## Administrative Claims

- The issue of whether a governmental entity that undertakes plugging and abandonment, clean-up or similar remediation costs can bring an administrative claim or would only have an unsecured claim is goes back to the question of whether the estate can abandon burdensome property.
- If the property cannot be abandoned, then the estate may have benefitted from any costs that are necessary to keep the property in safe condition.

## Sales Under Bankruptcy Code § 363

- Bankruptcy Code § 363 is a cornerstone in energy reorganizations because it permits sales of bankruptcy estate property "free and clear" of liens.

## The trustee may sell property under Bankruptcy Code § 363 free and clear of liens, only if:

- 1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
- 2) such entity [holding the interest] consents;
- 3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- 4) such interest is in bona fide dispute; or
- 5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

- These interests do not generally include easements or covenants that run with the land.
- The trustee also cannot sell free and clear of a co-owner's interests or other person's property interests unless there is compliance with special statutory protections.
- A sale free and clear requires a notice of sale be sent to all creditors or parties who have liens or other interests in the assets being sold.
- This frequently requires notice to numerous oil and gas counterparties, oil and gas lessors, creditors, and regulatory authorities.



- Secured creditors may credit bid their claims in a sale under Bankruptcy Code § 363. Nevertheless, cash payments may be required as part of the credit bid where certain senior lienholders are paid the full value of their secured lien claims on the assets.

Although using Bankruptcy Code § 363 is a valuable tool in many reorganizations, some courts prohibit or limit such sales as impermissible pre-arranged methods to sell selling substantially all of its assets without following plan procedures.



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