A Few Anticipated Hot Topics for Oil and Gas Bankruptcies

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Anticipated Hot Topics for Analysis and Jurisprudential Development

- OCSLA and Bankruptcy Collide
- Regulatory Issues with Enhanced Focus on Decommissioning and Financial Assurance
- Lease Maintenance and the Automatic Stay
- Unique Issues with Executory Contracts
- Abandonment of Decommissioning Obligations
- Working Interest Partner Issues
OCSLA and Bankruptcy Collide
OCSLA In General

- 43 USC §1331, et seq.
- Federal law applicable to the resources of the USA on the outer-continental shelf
- Congressional Declaration of policy 43 USC §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 USC §1333(a)(1) - Federal law, under OCSLA, applies on the OCS

- 43 USC §1333(a)(2)(A) - OCSLA includes a comprehensive choice-of-law scheme that incorporates the law of the adjacent State as “surrogate” federal law:
  
  “To the extent that they are applicable and not inconsistent with this Act or with other Federal laws, laws of each adjacent State are declared to be the law of the United States for the OCS . . . .”

- Non-conflicting laws of adjacent states “fill in the gaps” in OCSLA pursuant to this “mandatory” choice of law provision, which even overrides contractual choice of law provisions.
When does OCSLA apply surrogate state law?  
The PLT Test

Union Texas Petroleum Corp. v. PLT Engineering, Inc., 895 F.2d 1043 (5th Cir. 1990)

1. The controversy must arise on a situs covered by OCSLA (the subsoil, seabed, or artificial structures permanently or temporarily attached thereto);
   a. Tort – situs of tort
   b. Contract – situs of majority of performance under the contract

2. Federal maritime law must not apply of its own force
   i. Davis & Sons Inc. v. Gulf Oil Corp., 919 F.2d 313 (5th Cir. 1994) – Factors to determine the characteristics of a contract

3. State law must not be inconsistent with federal law.
Determining State Adjacency

- **Reeves v. B & S Welding, Inc., 897 F. 2d 178 (5th Cir. 1990)**
  - i. Geographic proximity
  - ii. Considerations of other federal agencies as to which state was adjacent to a particular offshore block
  - iii. Prior court determinations
  - iv. Projected boundaries
  - v. Other considerations
    - Rigs to reef blocks in area in which state is designated to share in cost savings
    - Which state does production ultimately flow
    - Which state’s economy is more impacted by the oil and gas activities
    - Other minor considerations
Pulling OCSLA into Bankruptcy

Classification of property interests in Bankruptcy is governed by non-bankruptcy law.

Onshore oil and gas property interest classification is clearly governed by state law.

On the OCS, arguably, OCSLA is the governing law for classifications of property interests.

The question of whether federal law or the law of the adjacent state defines an OCS property interest remains unsettled.

- If applicable federal law exists, is there even a need for state law as gap filler?
- And is this what was intended? What property law should define OCS mineral interests? What was the OCSLA choice of law provision meant to do?
ATP Adversary Proceedings

- Stage was set for initial decision
- Extensive briefing by quality lawyers
- Issue: Does Louisiana law, as adjacent state 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?
The ORRI and NPI owners argued that OCSLA mandates Louisiana law apply, and all mineral rights are therefore real rights, incorporeal immovables and alienable.

The ORRI and NPI owners argued for application of OCSLA in its traditional sense so that the property of the estate exclusion provided by 11 USC §541(b)(4) applies.

They argued the underlying OCS lease was an immovable, and therefore the carved out ORRI’s and NPI’s were immovable rights.
Interior argued that OCS leases were both unexpired leases of non-residential real property and executory contracts

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.

Interior argues that 11 USC §365 governs OCS leases
Personal Thoughts

- Interior’s argument may allow OCS lessees to cherry pick their OCS leases; they can reject the non-economic leases and assume the productive leases.
- This new philosophy is contrary to prior experience with Interior on these issues.
- 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.
Regulatory Issues with Enhanced Focus on Decommissioning and Financial Assurance
§ 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.

(f) Re-enter a well that was previously plugged according to this subpart.
¶ 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

30 CFR 556.62 (Assignment of Lease or interest in lease)

This section explains how to assign record title and other interests in OCS oil and gas or Sulphur leases.

(a) BOEM may approve the assignment to you . . . only if:

(2) You provide the bond coverage required by subpart I of this part;

(d) You, as assignor, are liable for all obligations that accrue under your lease before the date that the Regional Director approves your request for assignment . . . . The Regional Director’s approval of the assignment does not relieve you of accrued lease obligations that your assignee, or a subsequent assignee, fails to perform.

(f) If your assignee, or a subsequent assignee, fails to perform any obligation of the lease or the regulations in this chapter, The Regional Director may require you to bring the lease into compliance to the extent the obligations accrued before the Regional Director approved of the assignment of your interest in the lease.
Regulatory
Decommissioning Liabilities

In re Anadarko Petroleum Corporation,
187 IBLA 77, decided February 12, 2016
Regulatory
Decommissioning Liabilities

30 CFR 556.64 (How to file transfers)

This section explains how to file instruments with BOEM that create and/or transfer interests in OCS oil and gas and Sulphur leases.

(a) You must submit to the Regional Director for approval all instruments which create or transfer ownership of a lease interest.

* * *

(5) You do not gain a release of any nonmonetary obligation under your lease or the regulations in this chapter by creating a sublease or transferring operating rights.

(6) You do not gain a release from any accrued obligation under your lease or regulations in this chapter by assigning your record title interest in the lease.
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 no question that under Texas law, the owner of an operating interest is required to plug wells that have remained unproductive for a year.” For the 5th Circuit no abandonment of property that had outstanding plugging liability was possible without addressing the question of whether there was risk of imminent harm to the public.

Decommissioning is an “actual and necessary” cost of administering the estate, and costs are therefore administrative expense claims.
Current BOEM Bonding Guidelines

- Start with general lease surety bonds (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:

<table>
<thead>
<tr>
<th>Lease Activity</th>
<th>Lease Specific Bond Amount</th>
<th>Area-Wide Bond</th>
</tr>
</thead>
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<tr>
<td>No approved operational activity</td>
<td>$50,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Exploration Plan</td>
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<tr>
<td>Development Production Plan</td>
<td>$500,000</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Pipeline - ROW</td>
<td>N/A</td>
<td>$300,000</td>
</tr>
</tbody>
</table>
Current BOEM Bonding Guidelines

- **Supplemental Bonds (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
- BOEM is in the process of replacing NTL 2008-N07 with an updated Notice to Lessees, which will effectively eliminate the concept of exemptions 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

1) Sole uncovered properties
   i. Inactive (relinquished, terminated or expired) properties
   ii. Active (not relinquished, not terminated or not expired) properties

2) Properties with no active co-lessees (may have predecessors)
   i. Inactive properties
   ii. Active properties

3) Properties with active co-lessees
   i. Inactive properties
   ii. 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
Other Regulatory Considerations

- Idle Iron decommissioning
- HSE included in 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.
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 days unless resume operations or receive a suspension of operations or a suspension of production

- Operations = drilling, well-reworking, production in paying quantities
Non-OCS Lease

Maintenance Generally

- Non-OCS leases and generally maintained by their terms
- There may be regulatory issues associated with leases granted by states and state-based political subdivisions
§ 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).
§ 250.172 When may the Regional Supervisor grant or direct an SOO or SOP? 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 (see § 250.177(a)).

- **(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

§ 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.
Suspensions
Granted and Directed

§ 250.174 When may the Regional Supervisor grant or direct an SOP?

The Regional Supervisor may grant or direct an SOP when the suspension is in the National interest, and it is necessary because the suspension will meet one of the following criteria:

- (a) It will allow you to properly develop a lease, including time to construct and install production facilities;
- (b) It will allow you time to obtain adequate transportation facilities;
- (c) It will allow you time to enter a sales contract for oil, gas, or sulphur. You must show that you are making an effort to enter into the contract(s); or
- (d) It will avoid continued operations that would result in premature abandonment of a producing well(s).
Suspensions
Granted and Directed

(a) A suspension may extend the term of a lease (see § 250.180(b), (d), and (e)). The extension is equal to the length of time the suspension is in effect, except as provided in paragraph (b) of this section.

(b) A Directed Suspension does not extend the term of a lease when the Regional Supervisor directs a suspension because of:

1. Gross negligence; or
2. A willful violation of a provision of the lease or governing statutes and regulations.
Automatic Stay

11 USC § 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?
Assertion of Regulatory Rights

- Recommend that bankruptcy 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
- File IBLA appeals as appropriate
- Initiate automatic stay litigation if circumstances require
Unique Issues with Executory Contracts
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.”


- The Fifth Circuit, covering Louisiana, Texas and Mississippi has adopted the Countryman definition. **In re Murexco Petroleum, Inc.**, 15 F. 2d 60 (5th Cir. 1994)

- **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


(a) Business Judgment Test
(b) Rejection Damages
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 (S.D.N.Y. 2016) – bankruptcy court places itself in position of the debtor in possession and determines whether assuming or rejecting contract would be a good business decision or a bad one
Executory contracts peculiar to oil and gas bankruptcies

1. Gas Gathering Agreements (e.g. Midstream Agreements)
2. Mineral Leases
3. Purchase and Sale Agreements
4. Farmout Agreements
5. Production Handling Agreements
6. Joint Operating Agreements
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 but no final determination on whether the covenants at issue run with the land
  - 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
Gas Gathering Agreements

- **In re Quicksilver Resources, Inc., Case No. 15-10585 (Bankr. Delaware)**
  - Can Debtor reject midstream agreements when rejection is required by approved purchaser of Debtor's assets? This takes analysis into another level; now have a third party purchaser involved

- **In re Energy & Exploration Partners, Inc., Case No. 15-44931 (Bankr. N.D. TX)**
  - Debtor asked court to find that a dedication in a gathering agreement is not a covenant running with the land in order to limit a creditor's ability to use the gathering agreement as leverage to setoff amounts owed to it.

- **In re Magnum Hunter Services Corp., Case No. 15-12533 (Bankr. Delaware)**
  - Debtor filed suit 3/18/2016 seeking to nullify a gas purchase agreement with Oneok Rockies Midstream, arguing it does not contain covenants running with the land
Non-OCS Mineral Leases

- **In re WRT Energy Corp.,** 202 B.R. 579 (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 (W.D. La. 1992)
Asset Purchase Agreements and Related Agreements

- **In re Murexco Petroleum Corp.,** 15 F. 3d 60 (5th Cir. 1994)
- **Delta Energy Resources v. Damson Oil Corporation,** 72 B.R. 7 (W.D. La. 1985)
- What about asset exchange agreements?
Rights of First Refusal


- **In re CB Holding Corp., 448 B.R. 684 (D. Del. 2011)** – a right of first refusal is an executory contract subject to rejection.

- **In re Kellerstom Industries, Inc., 286 B.R. 833 (D. Del. 2002)** – a right of first refusal is an executory contract subject to rejection.
Farmout Agreements

- Not just an 11 U.S.C. § 365 issue (Debtor as Farmee)
- 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 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.
11 U.S.C. § 541(b)(4)

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;
Production Handling Agreements

- In re Panaco, Inc. (Case No. 02-37811) (USBC SDTX)
- Moral of story
- 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 gas are produced from the wells in questions; thus, the operating agreements are executory contracts.


- **In re Panaco, Inc., 2002 WL 31990368 (Bankr. S.D. Tex.)**

- Most courts, without litigation proceeding to a published decision, treat JOA’s as assumable contracts.
Abandonment of Decommissioning Obligations
§ 554 Abandonment of property of the estate

- The trustee of 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 (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)
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 certain properties.

Under decommissioning regulations, DOI could look to ATP’s predecessor in interest to satisfy “accrued” 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
The court permitted abandonment in light of Midlantic.

The Court was not unsympathetic to ATP’s predecessor in interest, which 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)**
- **In re Cronus Offshore, Inc., 05-36492 (USBC SDTX)**
- **In re Matagorda Island Gas Operations, LLC, 14-51099 (USBC WDLA)**
Contracting Around Residual Liability

- Residual liabilities considered in the PSA
- Use of performance bonds or decommissioning escrow accounts to guarantee performance is commonplace
  - Be careful of property of the estate issues
- Careful of who may be the last owner in the chain of title
Working Interest Partner Issues
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 often market the product 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.
Security Rights under JOA

- 810 AAPL JOA (deepwater)
  - Exhibit F – Article 6.3 – Security Rights
    - Mortgage and Security Interest in favor of Operator and Non-Operator (LA)
    - First Lien and Security Interest in favor of Operator and Non-Operator (TX)

- 710 APPL JOA (shelf)
  - Exhibit I – Article 8.6 – Security Rights
  - Perfect lien and security interest – state law controls
    - Memorandum of JOA in parish/county
    - UCC-1 in Secretary of State records
  - Interplay with mortgage subordinations and public records doctrine
  - Grace-Cajun Oil Co. v FDIC, 882 F. 2d 1008 (5th Circuit 1989)
Consent

- 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
Waiting for debtor to decide whether to assume or reject

- 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 – 11 U.S.C. § 365(d)(2); Texas Importing Co. v. Banco Popular de Puerto Rico, 360 F.2d 582, 583 (5th Cir. 1966)
COPAS and the Joint Account

- Operator pays all costs incurred under the JOA; reimbursement from each Party according to its Participating Interest

- Joint Account is a COPAS Concept
  - Council of Petroleum Accountants Societies
  - Form 710 JOA – COPAS 2005 Accounting Procedure
  - Form 810 JOA – COPAS 2012 Deepwater Accounting Procedure
    - New Deepwater JOA form modified to better track the COPAS 2012 Deepwater Accounting Procedure

- “Joint Account,” for OCS Shelf Operations, means the account showing the charges paid and credits received in the conduct of the Joint Operations that are to be shared by the Parties, but it does not include proceeds attributable to hydrocarbons and by-products produced under the Agreement. – COPAS 2005, AAPL 710-2002 JOA

- For Deepwater Operations under the AAPL 810-2007 JOA, the definition of Joint Account in the form was somewhat different from that in the COPAS 2012 Procedures (could be interpreted to include accounts pertaining to hydrocarbons and proceeds). The terms of the 810-2007 JOA form controlled over COPAS.

- “Joint Account” in the new Deepwater JOA form refers to the definition in COPAS 2012: “Joint Account” means the account showing the charges paid and credits received in the conduct of the Joint Operations that are to be shared by the Parties, but does not include accounts pertaining to volumes or proceeds attributable to hydrocarbons and by-products produced under the Agreement.

- COPAS is silent on the issue of netting, off-setting, taking-in-kind, etc.; addressed in the Operating Agreement
  - Right to take production in kind
  - Netting v. Billing
  - JIBs
  - Advanced billing and cash calls
NON-CONSENT OPERATIONS – Article 13 (Shelf) Article 16 (Deepwater)

- Arises automatically in some situations (Exploratory and Development Elections)

- Relinquishment of interest and Production Recoupment
  - Non-Participating Party’s interest in operations and title to hydrocarbons vests in each Participating Party in proportion to their interest until recoup specified amount
  - What does this mean for a party who is placed into bankruptcy during the non-consent/consent period? Is the subject interest in operations and title to hydrocarbons included in/excluded from property of the estate?

- Deepening or sidetracking a Non-Consent Well – Right to participate

- Allocations of costs between consent and non-consent operations

- Lease Maintenance Exceptions
  - Operations proposed within last __ months of primary term, or to perpetuate lease are “Lease Maintenance Operations”
  - Parties must receive notice/AFE stating is Lease Maintenance Operation
  - Non-consent well concerns
WITHDRAWAL –
Article 15 (Shelf)
Article 17 (Deepwater)

- Withdrawal Notice – in writing to all Parties
- Joinder in withdrawal – within 30 days, others may join in withdrawal by written notice
- Effect of withdrawal on non-withdrawing parties – can debtor withdraw during pendency of bankruptcy?
  - Withdrawal Notice is unconditional, irrevocable offer to convey 100% WI to the Remaining Party
  - Remaining Party must provide Operator written rejection or acceptance of its share of each Withdrawing Party’s WI
    - Failure to elect deemed acceptance.
- Limitations on withdrawal – would debtor rather reject JOA than withdraw, so that it is relieved from these below limitations/obligations?
  - Liable for prior expenses
  - Pay or provide security for its share of P&A
  - Prior to effective date of withdrawal, all liens, charges, encumbrances on Withdrawing Party’s WI shall be fully satisfied or released (or assumed by Remaining Parties)
  - Remain bound by Confidentiality Provisions of JOA
  - Not permitted during Force Majeure or emergency
Exhibit usually identifies insurance to be procured by the operator for parties with charges to the Joint Account

- Form Exhibit B now available for Deepwater JOA

Parties free to procure their own insurance

- For Deepwater, self-insurance permitted only if party meets certain financial requirements

If Debtor/Operator procures insurance for Joint Account and claim paid while in bankruptcy, what happens to those proceeds? Are they property of the estate or somehow protected therefrom? Are those proceeds monies held in “trust” by the Debtor for the benefit of the Joint Account, so they are excluded from property of the estate?

Operator usually required to procure supplemental bonds as required

Although premiums can be charged to the Joint Account, what about collateral?

If Joint Account posts collateral but co-interest owner files bankruptcy, is that collateral Property of the Estate so that co-interest owners lose any rights to it?
As between the Parties, liabilities are several

Each Party holds the other harmless from liens/encumbrances it causes

Liability for damages (Shelf)

- Borne by each in proportion to its Participating Interest
- Gross negligence/willful misconduct exception

Liability for damages (DW) – 2 Options:

1. Shared by all up to certain $ (including gross negl/willful misconduct)
2. Excludes gross negligence/willful misconduct for actions of Senior Supervisory Personnel

- All parties must pay JIBs until final adjudication of GN/WM allegation

Special provisions for non-consent situations

- Non-Participating Party liable for its negligence/fault/strict liability (Shelf)
- Non-Participating Party liable only for its GN/WM (DW)

Complete waiver/release of consequential damages, regardless of fault, including GN/WM (DW)

How does the automatic stay affect the contractual allocation for liabilities, claims and lawsuits among the Joint Account?
TRANSFER OF INTEREST AND PREF RIGHTS – Article 26 (Shelf)
Article 24 (Deepwater)

- Before WI can be transferred, written Transfer Notice to all Parties
- Within 20 days, parties may exercise preferential right to purchase its Participating Interest share of WI offered
- Exceptions:
  - Mortgages/grants of security interests
  - Grants of ORRI
  - NPI or production payment
  - Package sale of assets
  - Transfers to Affiliates, etc.
- Offer must be accepted on same/identical terms as were offered by third party and accepted by transferring party; must keep seller in same position as if it had transferred to a third party
- For Deepwater, options based on retained liability of transferor
  1. Retains liability for accrued obligations only;
  2. Retains liability for accrued or future obligations; or
  3. Retains liability for accrued obligations but only liable for future obligations if transferee fails to meet definition of “financially capable party” as set forth in JOA
- Can a co-interest owner reject a JOA and shed its retained liability?
Partner Bankruptcy Litigation Issues

- Payment of LOE pre- and post-petition
- P&A Reserves and Escrows (In re Panaco)
- Application of operating agreement or state law?
  - Which is better?
- Pre-payments
- Bonding
- Security rights and ranking
- Consent/non-consent operational issues
A Few Anticipated Hot Topics for Oil and Gas Bankruptcies

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