Boom Times Gone: What Bankruptcy Practitioners and Professionals Can Expect in Oil, Gas and Energy Chapter 11 Cases and Restructurings

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BOOM TIMES GONE: WHAT BANKRUPTCY PRACTITIONERS AND PROFESSIONALS CAN EXPECT IN OIL, GAS AND ENERGY CHAPTER 11 CASES

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THURSDAY, AUGUST 18TH
1:30 PM BREAKOUT SESSION

RECENT OIL, GAS, AND COAL BANKRUPTCY FILINGS

OIL AND GAS BANKRUPTCIES

- Linn Energy - $8.3 billion in debt
- Pacific Exploration & Production - $5.3 billion
- Samson Resources - $4.3 billion
- Ultra Petroleum - $3.9 billion
- Sabine Oil and Gas $2.9 billion
- Energy XXI - $2.8 billion
- Midstates Petroleum - $2 billion
- Venoco - $1.3 billion
- Swift Energy - $1.2 billion
- Energy & Exploration Partners - $1.2 billion
- Magnum Hunter Resources - $1.1 billion
- Milargo Oil & Gas - $1 billion
- New Gulf Resources - $600 million
- Goodrich Petroleum - $500 million
- ERG Resources - $400 million

COAL BANKRUPTCIES

- Peabody Energy - $10.1 billion
- Alpha Natural Resources - $7 billion
- Arch Coal - $4.5 billion
- Patriot (two filings) - $3.1 billion (first filing); $1 billion (second filing)
- Walter Energy - $3 billion
- James River - $1 billion

DISCUSSION:
RECENT ISSUES IN OIL, GAS AND ENERGY BANKRUPTCIES

I. Adequate Protection
   a. The debtor bears the burden of proving the necessity of adequate protection and the party demanding adequate protection has the burden of proving its interest in property of the estate
   b. Oil and gas interests, by their nature, are depleting assets, resulting in adequate protection issues rising to the forefront
   c. How will these assets be valued to determine adequate protection?
      i. Examples: income approach, market comparables, replacement costs, liquidation values

II. Reclamation and Regulatory Obligations
   a. Reclamation and regulatory issues continue to be ongoing issues for coal companies, particularly with respect to the Federal Surface Mining Control and Reclamation Act of 1977 ("SMCRA") claims and claims under the Clean Water Act
   b. Particularly important is the abandonment of property that contains extensive reclamation and regulatory obligations
   c. An argument might be advanced that *Midlantic National Bank v. New Jersey DEP*, 474 U.S. 494 (1986) prohibits the abandonment of property in contravention of a state statute or regulation that is reasonably designed to protect public health or safety
   d. Should debtors have the authority to abandon property with extensive reclamation liabilities?

III. Executory Contracts vs. Real Property Interests
   a. In some jurisdictions, it is unclear if oil and gas interests are executory contracts or real property interests

i. *In re Energytec, Inc.*, 739 F.3d 215 (5th Cir. 2013): court discusses covenants that run with the land, specifically rights associated with gas pipelines, including the right to receive transportation fees

ii. *In re Aurora Oil & Gas Corp.*, 439 B.R. 674 (Bankr. W.D. Mich. 2010): court found oil and gas interest a lease as opposed to a real property interest

iii. Ohio Revised Code § 5301.09 (addressing recording of a lease for natural gas or petroleum): Ohio legislature amended § 5301.09 "to specify that a lease of natural gas and petroleum is an interest in real estate"

b. It is also unclear if gathering agreements constitute executory contracts or real property interests

i. *In re Sabine*, 547 B.R. 66 (Bankr. S.D. N.Y. 2016)

1. Judge Chapman held that debtor could use reasonable business judgment to reject its executory gathering contracts, despite contention that such agreements ran with the land

2. Sabine did not definitively answer whether debtor's gathering agreements run with the land

IV. Third Party Releases

a. Federal and state agencies can "permit block" a coal company, its affiliated entities, and individuals deemed to be "in control" of the permitted entity as a means to ensure compliance with environmental regulations

b. Chapter 11 plans have provided non-debtor third-party releases and injunctions as a means to avoid permit blocking

c. This issue is divided among circuits that allow non-debtor third-party releases in chapter 11 plans

i. The Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits are pro-release and allow for non-consensual third-party releases (within limitation)

ii. The Fifth, Ninth, and Tenth Circuits disfavor non-debtor third-party releases

V. Collective Bargaining Agreements

a. Energy companies typically have inadequately funded retirement plans, and the burden of paying retirement obligations is significant

b. Collective bargaining agreements are treated differently from executory contracts and leases and are protected by special provisions in section 1113 of the Bankruptcy Code

c. Pursuant to section 1113 of the Bankruptcy Code, a collective bargaining agreement may be rejected if the debtor provides the union information about the company and submits a formal proposal to modify the collective bargaining agreement, which is rejected by the union

i. The collective bargaining agreement can then be set aside if the debtor's proposed changes are necessary for a reorganization

ii. Determining what qualifies as necessary for a reorganization has been the subject of disagreements among courts

VI. Joint Operating Agreements

a. Joint operating agreements (JOA) are common in the oil and gas industries

b. If one party to a JOA files for bankruptcy, significant operational issues are raised

c. The debtor does not have to perform its obligations under the JOA, but the non-debtor party is required to continue performing operations

d. What about expenses incurred by the non-debtor operator during the bankruptcy?

i. Courts will typically turn to state law to determine interests and obligations

1. *In re Wilson*, 69 B.R. 960 (Bankr. N.D. Tex. 1987): court held that law of co-tenancy applied after bankruptcy filing, and held that co-tenant could deduct its reasonable costs

from operations before accounting to the debtor co-tenant their share of production

VII. Forward Contracts

a. Section 556 of the Bankruptcy Code preserves the right of a forward contract merchant to terminate the contract

b. No published authority exists determining whether a coal supply agreement is a forward contract or whether an end-user or producer qualifies as a forward contract merchant

c. These issues have been raised in numerous coal bankruptcies but have not lead to published decisions; rather, debtors have chosen to settle these issues with utility providers

Legal Update on Recent Oil, Gas, and Coal Bankruptcies

Ronald E. Gold

Largest Bankruptcy Cases Filed

- Oil and Gas Bankruptcies
  - *Pacific Exploration & Production – $5.3 billion in debt*
  - *Samson Resources – $4.3 billion*
  - *Ultra Petroleum – $3.9 billion*
  - *Sabine Oil & Gas – $2.9 billion*
  - *Energy XXI – $2.8 billion*
  - *Quicksilver Resources – $2.1 billion*
  - *Midstates Petroleum – $2 billion*
  - *Venoco – $1.3 billion*
  - *Swift Energy – $1.2 billion*
  - *Energy & Exploration Partners – $1.2 billion*
  - *Magnum Hunter Resources – $1.1 billion*
  - *Milagro Oil & Gas – $1 billion*
  - *New Gulf Resources – $600 million*
  - *Goodrich Petroleum – $500 million*
  - *ERG Resources – $400 million*
- Coal Bankruptcies
  - *Peabody Energy - $10.1 billion*
  - *Alpha Natural Resources - $7 billion*
  - *Arch Coal - $4.5 billion*
  - *Patriot (two filings) - $3.1 (first filing), $1 billion* (second filing)
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  - *James River - $1 billion*

Legal Update on Recent Oil, Gas, and Coal Bankruptcy Issues

- Gathering Agreements
  - *In re Sabine*, 547 B.R. 66 (Bankr. S.D.N.Y. 2016)
    - Debtor moved to reject its gathering agreements with companies that processed gas and other hydrocarbons removed from debtor's wells
    - Judge Chapman held that it was a reasonable business decision for the debtor to reject its executory gathering contracts despite contention that debtor's obligations ran with the land
    - *Sabine* did not definitively answer whether or not the debtor's gathering contracts run with the land
- Coal Supply Agreements as Forward Contracts
  - Section 556 of the Bankruptcy Code provides that the right of a forward contract merchant to terminate a forward contract is not limited in bankruptcy

    - No published authority determining whether a coal supply agreement is a forward contract or whether an end-user or a producer can be a forward contract merchant
        - Raised by utility provider in *U.S. Coal*, and settled for payment of $2M by utility
        - Raised by same utility in *JW Resources* and settled
- U.S. Clean Power Plan
    - The U.S. Clean Power Plan proposes to reduce carbon emissions from the power sector, and compliance can prove costly
    - *In re Murray Energy Corp*., No. 14-1112 (D.C. 2014) and *West Virginia v. EPA*, No. 14-1146 (D.C. 2014), both cases sought to challenge the proposed Clean Power Plan regulations, which were consolidated for the U.S. Court of Appeal for the D.C. Circuit
    - Both cases were rejected on procedural grounds, as the D.C. Circuit found that the claimants had not experienced any injuries. However, these cases prove the willingness of other parties to challenge the promulgation of energy regulations
- Section 363 Sales
    - *In re Manalapan*, 2015 WL 3827022 (Bankr. E.D. Ky.)
        - Lessor argued that trustee could not assign mining lease because lease was rejected as a matter of law under section 365, and pursuant to section 363 the proposed conveyance was not allowed
        - Judge Schaaf held that section 365 did not control because the mining lease is not a lease under Kentucky law; instead, it is a conveyance of real property
        - Section 363 permitted the trustee to convey the mining lease, despite the assignee not being committed to accepting the mining lease or related permits
- Reclamation and Regulatory Issues
    - Reclamation and regulatory issues continue to be ongoing issues for coal companies, particularly with respect to Federal Surface Mining Control and Reclamation Act of 1977 ("SMCRA") claims and claims under the Clean Water Act
    - Particularly important is the abandonment of property that contains extensive reclamation and regulatory obligations
    - According to *Midlantic National Bank v. New Jersey DEP*, 474 U.S. 494 (1986), a trustee cannot abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety of identified hazards
        - SMCRA and the Clean Water Act might be construed as the type of issues referenced by *Midlantic*
- Third Party Releases
    - Federal and state agencies can "permit block" a coal company, its affiliated entities, and individuals deemed to be "in control" of the permitted entity as a means to ensure compliance with environmental regulations

    - Increasingly, debtors have been providing third-party releases and injunctions as part of a chapter 11 plan to prevent "permit blocking"
    - Usually, this issue divides among circuits that allow third party releases in plans and those circuits that do not
        - The Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits are pro-release and allow for non-consensual third-party releases, within limitation
        - The Fifth, Ninth, and Tenth Circuits do not approve of third-party releases
    - Recently, the Bankruptcy Court for the Eastern District of Virginia confirmed Alpha Natural Resource's chapter 11 plan, which provided for third-party releases
- Executory Contracts or Real Property Interests
    - In some jurisdictions, it is not clear if oil and gas interests are executory contracts or real property interests
        - *In re Energytec, Inc.*, 739 F.3d 215 (5th Cir. 2013): court discusses covenants that run with the land, specifically rights associated with a gas pipeline, such as the right to receive a transportation fee based on gas moving through the pipeline
        - *In re Aurora Oil & Gas Corp.*, 439 B.R. 674 (Bankr. W.D. Mich. 2010): court held that oil and gas lease is a lease
        - In 2014, the Ohio legislature amended O.R.C. § 5301.09, which concerns the recording of a lease for natural gas and petroleum "to specify that a lease of natural gas and petroleum is an interest in real estate," thereby ending longstanding uncertainty in Ohio