Fueling the Bankruptcy Fire: Restructuring the Oil & Gas Industry

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US Oil & Gas:
Adequate Protection Issues

- Adequate protection is mandatory when required
  - *In re Metromedia Fiber Network, Inc.*, 290 B.R. 487, 491 (Bankr. S.D.N.Y. 2003)
  - *In re The Great Atlantic & Pacific Tea Co., Inc.*, 544 B.R. 43, 56 (Bankr. S.D.N.Y. 2016)
  - *Resolution Trust Corp. v. Swedeland Dev. Grp. (In re Swedeland Dev. Grp.)*, 16 F.3d 552, 564-65 (3d Cir. 1994)
- The Debtor has the burden of proving adequate protection
  - *Wilmington Trust Co. v. Aardvark, Inc. (In re Aardvark, Inc.)*, 1997 WL 129346, at *4 (D. Del. Mar. 4, 1997)
- The party demanding adequate protection has the burden of proving its interest in property of the estate
- Adequate protection most often granted with cash payments and replacement liens

US Oil & Gas:
Adequate Protection Issues

- Oil and gas assets by their nature are depleting assets
  - Rhett Campbell, *A Survey of Oil and Gas Bankruptcy Issues*, 5 TEX. J. OIL GAS & ENERGY L. 265, 314 (2010)
  - *Karnes v. Salem Nat'l Bank (In re Fullop)*, 125 B.R. 536, 541 n.5 (Bankr. S.D. Ill. 1990)
  - *Halliburton Servs. v. First City Energy Finance Co. (In re Endrex Exploration Co.)*, 101 B.R. 474, 476 (N.D. Tex. 1988)
  - *Wayne United Gas Co. v. Owens-Illinois Glass Co.*, 91 F.2d 827, 830 (4th Cir. 1937)
- Adequate protection valuation of collateral is to be determined either as of the petition date or as of the date on which the request for adequate protection is made
- The petition date is typically the starting point for adequate protection
  - *In re Dheming*, 2013 WL 1195652, at *1 (Bankr. N.D. Cal. Mar. 22, 2013)

US Oil & Gas:
Adequate Protection Issues

- The valuation methodology can have significant impact in adequate protection matters (income approach, market comparables, replacement cost, liquidation value, reserve valuations – relevance of PV10)
- Valuation shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest. 11 U.S.C. § 506(a)
- "[T]he purpose of the adequate protection requirement is to protect the creditor from loss occasioned by the debtor's use, sale or lease of the collateral while attempting to liquidate or reorganize."
  - COLLIER ON BANKRUPTCY ¶ 506.03[7][a][ii] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.)
- The value to be protected is the value of the creditor's current interest viewed from the creditor's perspective of equivalent value
  - *In re WPRV-TV, Inc.*, 102 B.R. 228, 230 (Bankr. E.D. Okla. 1988)
  - *Lightstyles, Ltd. v. Susqehanna Bank (In re Lightstyles, Ltd.)*, 2012 WL 3115902, at *3 (Bankr. M.D. Penn. July 27, 2012)

US Oil & Gas:
Financing the Energy DIP (Upstream)

- DIP financing can be provided in several ways
  - Enabling DIP to facilitate acquisition by DIP lender/potential purchaser
    - Done in conjunction with purchase agreement and is part of purchase price consideration (fees, interest may provide some price advantage)
    - Set sale process milestones via the DIP and sale procedures
    - Determine whether to prime or subordinate to secured lenders, priming preferred, although purchase may justify accepting a subordinate position
  - Preservation DIP by the existing secured lender(s)
    - Purchase of secured debt at discount may offer path to DIP lending with advantageous credit bid rights
  - Opportunistic DIP by new lender if value supports new priming lending
    - Potential for competitive process to be selected as DIP lender
    - May be subject to valuation contest by secured lenders being primed

US Oil & Gas:
Financing the Energy DIP (Upstream)

- Reserve based loan ("RBL")
  - Based on the proven reserves of the borrower
  - Basic terms for upstream energy reserves
    - PDP (proven, developed, producing)
    - PDNP (proven, developed, not producing/"behind pipe")
    - PUD (proven, undeveloped)
    - Probable
    - Possible
  - Borrowing base tied to the amount of proven reserves
  - Borrowing base is "redetermined", typically twice per year, but can be more often, and discretionary redeterminations have occurred, although not generally in the DIP financing context
  - Reporting tends to be more complex and is key to managing the loan
    - Budget compliance/reconciliation
    - Business plan/capex/AFEs
    - Swaps positions

US Oil & Gas:
Financing the Energy DIP (Upstream)

- Upstream DIP loans may have marketing and sales process timelines and benchmarks that must be met to avoid default
  - CIM developed
  - Data room
  - IOIs received
  - Motion to approve bidding procedures/sale filed
  - Bids received
  - Auction conducted
  - Sale approved
  - Sale consummated
  - Proceeds distributed (via sale order or plan as case may be)
- These timelines and benchmarks are sometimes modified depending on the circumstances of the case

US Oil & Gas:
Hedges/Swaps and Safe Harbor Issues

Safe Harbor Protections	Applicable Bankruptcy Code Section
CONTRACTUAL RIGHTS PROTECTED. Neither the Bankruptcy Code, the Court nor an administrative agency shall stay, avoid or limit a contractual right of the applicable protected party to liquidate, terminate, accelerate, net out (swaps and master netting agreements), offset (swaps and master netting agreements) or a right to a variation or margin payment received (open commodities contracts and forward contracts) because of a condition specified in 365(e)(1).	§ 555 (securities contracts), § 556 (commodities contracts and forward contracts), § 559 (repurchase agreements), § 560 (swap agreements) and § 561 (master netting agreements)
BANKRUPTCY AUTOMATIC STAY DOES NOT APPLY. The automatic stay under § 362(a) does not apply to the exercise by an applicable protected party of any contractual right under any security agreement or arrangement or other credit enhancement, or of any contractual right to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with such protected contract.	§ 362(b)(6) (commodity contracts, forward contracts and securities contracts), § 362(b)(7) (repurchase agreements, § 362(b)(17) (swap agreements) and § 362(b)(27) (master netting agreements)
COURT/ADMINISTRATIVE AGENCY CANNOT IMPOST STAY. The exercise of rights exempted from the automatic stay under §§ 362(b)(6), 362(b)(7), 362(b)(17) and 362(b)(27) shall not be stayed by any order of a court or an administrative agency in any proceeding under this title.	§ 362(o)
TRANSFERS PROTECTED. Transfers made before the commencement of the bankruptcy case in connection with a protected contract to or by (or for the benefit of) a protected party are not subject to avoidance as a preferential transfer or constructively fraudulent transfer. In addition, margin and settlement payments made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency in connection with a securities contract, forward contract or commodity contract. (Please note: transfers and payments are subject to avoidance as actual fraudulent transfers.).	§ 546(e) (commodities contracts, forward contracts and securities contracts), § 546(f) (repurchase agreements), § 546(g) (swap agreements) and § 546(j) (master netting agreements)

US Oil & Gas:
Hedges/Swaps and Safe Harbor Issues

- Upstream producers often hedge production to protect against a fall in the commodity price
- Most common hedge is the ISDA (International Swaps and Derivatives Association) swap agreement
- The Bankruptcy Code “safe harbor” provisions apply to swap agreements in the right circumstances
- The safe harbor provisions permit, among other things, the setoff of swap termination amounts against claims under the appropriate circumstances
- There is an exception to the automatic stay that applies to these types of setoffs

US Oil & Gas:
Hedges/Swaps and Safe Harbor Issues

Bankruptcy Code Section	Discussion
Section 560	
The exercise of any contractual right to cause the liquidation, termination, or acceleration of one or more swap agreements . . .	The right to terminate, liquidate, and offset may arise under a variety of sources, whether provided via statute, regulation, common law, or contract.
". . . of any swap participant or financial participant . . ."	Exercising party must be party to the swap agreement rather than an affiliate of the party to the agreement or an assignee of rights under the agreement.
". . . to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation or acceleration of one or more swap agreements . . ."	Amounts which are offset or netted out must be under or in connection with the swap agreement, usually via reference or incorporation.
Section 553	
"…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 the commencement of the case…"	Mutual debts/claims arise via the contractual obligations of applicable credit agreement and swap agreement.
Section 362(b)(17)	
"Exercise by a swap participant or financial participant . . ."	Exercising party must be party to the swap agreement – cannot be an affiliate of the party to the agreement or an assignee of rights under the agreement.
". . . under any security agreement or arrangement or other credit enhancement forming a part or of related to any swap agreement, or of any contractual right (as defined in section 560) . . ."	Security or credit agreement must be connected to the swap agreement, usually via reference or incorporation.
". . . to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements . . ."	Amounts which are offset or netted out must be connected to the swap agreement, usually via reference or incorporation.

US Oil & Gas: Hedges/Swaps and Safe Harbor Issues

- From the case law to date, several principles emerge
  - A bankruptcy case must be filed, and there must be a trigger of the rights under the swap agreement (*e.g.*, language in the swap agreement that a bankruptcy filing triggers such rights);
  - The right to terminate and offset must exist (*e.g.*, be contained in the swap agreement);
  - A right of offset must exist under applicable law;
    - Mutuality of the parties (as opposed to affiliates, assignees);
    - Mutuality of obligations (as opposed to special purpose accounts);
    - Mutuality of debts/claims (as opposed to post-bankruptcy deposits);
  - Debts/claims of swap and other agreements must arise under or in connection with the swap (reference, incorporation, and economic relationship);
  - The exercise of rights must be timely

US Oil & Gas:
Hedges/Swaps and Safe Harbor Issues

In re Lehman Bros., Inc., 458 B.R. 134 (Bankr. S.D.N.Y. 2011)	Foreign Exchange Swap Agreement (supported by 1992 ISDA Master Agreement)	Triangular setoff between affiliates, even though allowed under agreement, was not permitted in bankruptcy because it failed mutuality requirement. Section 553 of the Bankruptcy Code preserves parties' setoff rights, but requires that both parties' obligations are prepetition and that the debts be "mutual" — meaning they are in the same right, between the same parties, standing in the same capacity. Because there was no mutuality, UBS had no right to setoff, and was therefore in violation of the automatic stay. Court noted that because debts owed by the debtor to the UBS affiliates did not arise under the ISDA, the section 362(b)(17) exception to the automatic stay for termination of swaps did not apply. TRIANGULAR OFFSET
Bank of America, N.A. v. Lehman Brothers Holdings Inc. and Lehman Brothers Special Financing Inc. (In re Lehman Bros. Holdings Inc.), 439 B.R. 811 (Bankr. S.D.N.Y. 2010) ("BOA")	Security Agreement governing cash collateral account AND 1996 ISDA Master Agreement	Under New York common law, the deposit account was "a special purpose account" solely for overdraft protection, and thus, it was not eligible to setoff against an unrelated debt. BOA violated the automatic stay. Section 362(b)(17) did not apply because the collateral never had any relationship to BOA's swaps and was pledged exclusively to secure against overdrafts. UNRELATED SECURITY IN SPECIAL PURPOSE ACCOUNT
In re Lehman Bros. Holdings Inc., 433 B.R. 101 (Bankr. S.D.N.Y. 2010) ("Swedbank")	ISDA Master Agreement	Swedbank's offset is improper because mutuality is lacking — funds were deposited postpetition, but the debtor's indebtedness arose prepetition. Holding that "the mutuality requirement of section 553 precludes a creditor-bank from offsetting a debtor's pre-petition obligations against funds deposited with the creditor-bank post-petition." Sections 560 and 561 of the Bankruptcy Code did not render the mutuality requirement inapplicable to derivative contract counterparties. Even where valid right to setoff may exist, a bank must move for relief from the stay rather than freeze a bank account indefinitely. MUTUALITY OF DEBTS/CLAIMS MUST BE PREPETITION

US Oil & Gas:
Hedges/Swaps and Safe Harbor Issues

Swedbank AB (PUBL) v. Lehman Brothers Holdings Inc. and Official Committee of Unsecured Creditors of Lehman Brothers Holdings Inc. (In re Lehman Bros. Holdings Inc.), 445 B.R. 130 (S.D.N.Y. 2011)	ISDA Master Agreement	Affirmed Bankruptcy Court decision. Safe harbor protections of section 560 and 561 of the Bankruptcy Code do not eliminate mutuality requirement. Swedbank was entitled to terminate swaps and determine a net termination value, but safe harbor provisions did not permit setoff against postpetition assets that had no connection to the underlying swaps. MUTUALITY OF DEBTS/CLAIMS MUST BE PREPETITION
Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services Limited (In re Lehman Bros. Holdings, Inc.), 422 B.R. 407, 421 (Bankr. S.D.N.Y. 2010)	Swap Agreement, governing credit-linked synthetic portfolio notes	Supplemental proceeds-distribution documents were not part of an "integrated swap agreement", and therefore fell outside safe harbor provisions. Suggests that such distribution arrangements, if incorporated into the swap agreement itself, could be permissible. DIRECT SHARING OF SWAP PROCEEDS TO OTHER LENDERS NOT IN SWAP
Transcript Regarding Hearing Held September 15, 2009, In re Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 17, 2009) ("Metavante")	ISDA Master Agreement	Court issued a bench ruling granting the motion to compel and requiring Metavante to make all past due payments without regards to any defaults that may have occurred under the ISDA. Non-debtor counterparty's rights under the safe harbor are limited to liquidating, terminating, or accelerating its contracts, or netting its positions - nothing more. ISDA agreement is an executory contract and Metavante was not permitted under safe harbor to withhold performance. The court noted that the swap counterparty must exercise its rights under the safe harbors "fairly contemporaneously with the bankruptcy filing, lest the contract be rendered just another ordinary executory contract." TIMING TO EXERCISE SWAP RIGHTS UPON BANKRUPTCY FILING
In re SemCrude, L.P., 399 B.R. 388 (Bankr. D. Del. 2009	Purchase Agreements for various hydrocarbons, with netting provisions.	Court held that triangular setoff between separate corporate entities was not permitted because the mutuality requirement imposed by section 553 of the Bankruptcy Code was not satisfied. There was no "contract exception" to the mutual debt requirement. Allowing parties to contract around mutuality requirement would allow one creditor or a handful of creditors to "unfairly obtain payment from a debtor at the expense of the debtor's other creditors, thereby upsetting the priority scheme of the Bankruptcy Code and reducing the amount available for distribution to all creditors." TRIANGULAR OFFSET

Midstream Agreements in Bankruptcy

Overview of Midstream Agreements

- Exploration and production ("E&P") companies generally rely on (and contract with) midstream service providers to gather, process and transport oil and gas from the well to the market.
- Midstream service providers often invest capital upfront to build the facilities/systems and construct the pipelines necessary to support the services to be provided.
- Midstream service agreements often include:
  - An acreage dedication: The E&P company dedicates all of the gas and oil produced in a certain area to the performance of the agreement. The agreement may (and often does) expressly provide that the acreage dedication is a covenant that runs with the land.
  - A minimum volume commitment: The E&P company commits to provide a minimum volume of oil or gas to the midstream service provider (and to pay a fee if the company fails to satisfy the minimum requirement).
- Given current market conditions, some midstream agreements – particularly those with significant volume commitments and high deficiency fees – may no longer be favorable or financially viable for E&P companies.
  - E&P companies are grappling with weak demand, plummeting prices, reduced liquidity (due to, among other things, shrinking borrowing bases) and tightening capital markets.

Rejection of Midstream Agreements

- If an E&P company commences a chapter 11 case, it may seek to reject disadvantageous midstream service agreements.
- Midstream service providers have argued that midstream contracts – or at a minimum the acreage dedications described above — "run with the land" and, thus, are not subject to rejection or, alternatively, the covenant remains notwithstanding rejection.
  - A ruling adopting this argument (or holding that dedications constitute real property interests) could potentially impact the priority and scope of claims held by E&P companies' secured creditors.
- The extent to which midstream agreements (and particularly the covenants discussed above) are subject – or immune – to rejection remains unclear and may vary depending on the terms of an agreement and applicable state law.

Sabine Oil & Gas Corp. Case No. 15-11835 (Bankr. S.D.N.Y. 2015) – Background

- Sabine is an upstream exploration and production company formed in late 2014.
- On July 15, 2015, Sabine and certain of its subsidiaries (the "Debtors") filed voluntary chapter 11 petitions with the Bankruptcy Court for the Southern District of New York.
- In late September 2015, the Debtors filed a motion seeking to reject four midstream gathering agreements (the "Agreements") with two counterparties – Nordheim Eagle Ford Gathering LLC ("Nordheim") and HPIP Gonzalez Holdings, LLC ("HPIP").
- While different in some respects, the Agreements shared certain common features; among other things, each:
  - was governed by Texas law;
  - included dedication provisions; and
  - expressly provided that the dedication provisions would run with the land and be enforceable against successors and assigns.

Sabine –Background (continued)

- The Debtors maintained that:
  - satisfying the volume requirements under the Agreements was no longer financially viable;
  - as a result, absent rejection, the Debtors would be required to make substantial deficiency payments that would consume the estates' resources;
  - rejection of the Agreements would provide up to $115 million in aggregate cost savings for the Debtors' estates; and
  - if the rejection motion was granted, the Debtors could pursue new gathering agreements with other parties on more favorable terms.
- Both counterparties maintained that the Debtors should not be permitted to reject covenants running with the land under the Agreements.
  - HPIP maintained that the Court should determine whether the covenants run with the land in the context of the pending rejection motion. However, Nordeim argued that the issue must be teed up in a separate adversary proceeding.
- Nordheim also maintained that the Debtors' decision to reject the agreements was not reasonable and could not satisfy the business judgment standard because the key covenants run with the land and, thus, would survive rejection; rejecting the remainder of the agreements, according to Nordheim, would confer little (or no) benefit to the Debtors' estates.

Sabine –Background (continued)

- On March 8, 2016, Judge Shelley Chapman granted the Debtors' motion to reject the Agreements and provided her non-binding analysis as to whether covenants run with the land under Texas law. *In re Sabine Oil & Gas Corp.*, 547 B.R. 66 (Bankr. S.D.N.Y. 2016) (the "March Decision").
  - Judge Chapman concluded that she could not make a final determination regarding the status of the covenants (*i.e.*, whether they ran with the land) in the context of the motion to reject.
- Shortly after the ruling, the Debtors commenced separate adversary proceedings against Nordheim and HPIP seeking declaratory judgments that the covenants at issue did not run with the land.
- On May 3rd, Judge Chapman held that the covenants do not run with the land, incorporating (and supplementing) the analysis set forth in her initial, non-binding decision. *Sabine Oil & Gas Corp.* v. *HPIP Gonzales Holdings, LLC* (*In re Sabine Oil & Gas Corp.*), Adv. Proc. Nos. 16-01042 (SCC) & 16-01043 (SCC), 2016 WL 2603203 (Bankr. S.D.N.Y. May 3, 2016) (the "May Decision").

Sabine – Rejection Ruling

- In the March Decision, Judge Chapman noted that:
  - bankruptcy courts apply the deferential "business judgment test" when considering rejection motions (*i.e.*, courts consider "whether the debtor's decision to assume or reject is beneficial to the estate");
    - bankruptcy courts generally defer to a debtor's business judgment unless the rejection decision is "the product of bad faith, whim, or caprice;"
  - "[u]nless a separate provision of the Bankruptcy Code provides a non-debtor party with specific protection, the interests of the debtor and its estate are paramount; adverse effects on the nondebtor contract party arising from the decision to assume or reject are irrelevant[;]" and
  - the ultimate question for the Court is "whether a reasonable business person would make a similar decision under similar circumstances."
- Judge Chapman concluded that, irrespective of the ultimate determination with respect to the status of the covenants at issue, "the Debtors' conclusion that they are better off rejecting the . . . Agreements is a reasonable exercise of their business judgment."

Sabine – Covenants Running with the Land

- Judge Chapman found that the covenants at issue do **not** run with the land as real covenants (or equitable servitudes) under Texas law.
  - As noted above, she issued a preliminary (non-binding) ruling in the March Decision and then incorporated, and supplemented, that ruling in the May Decision.
- Judge Chapman noted that, under Texas law:
  - "language in a contract containing a covenant is the primary evidence of the parties' intent. . . terminology is not dispositive[;]"
  - a "covenant runs with the land when (1) it touches and concerns the land; (2) it relates to a thing in existence or specifically binds the parties and their assigns; (3) it is intended by the original parties to run with the land; and (4) the successor to the burden has notice;" and
  - "[m]any courts have also required that the parties have horizontal privity of estate."

Sabine – Covenants Running with the Land (continued)

- Only three elements were in dispute:
  - the existence of horizontal privity of estate between Sabine and each counterparty;
  - the nature of the covenants (*i.e.*, whether they "touch and concern" the land); and
  - the parties' intent (*i.e.*, whether the parties intended the covenants to run with the land).
- Judge Chapman found that horizontal privity did not exist and that the covenants did not touch and concern the land. As a result, she did not address the parties' intent.

Sabine – Covenants Running with the Land (continued)

- Horizontal Privity
  - Under the traditional construct of horizontal privity, "parties seeking to create a covenant 'running with the land' would need to have some additional transactional element to their relationship and not merely be two parties seeking to covenant with one another."
  - The Court noted that it "involves a property owner reserving by covenant, either for itself or another beneficiary, a certain interest out of the conveyance of the property burdened by the covenant."

Sabine – Covenants Running with the Land (continued)

- Key Rulings in the March and May Decisions:
  - If horizontal privity is required under Texas law, it does not exist.
    - "The covenants at issue are properly viewed as identifying and delineating contractual rights and obligations with respect to the services to be provided, and not as reserving an interest in property."
    - The Debtors did not grant the counterparties a real property interest in their mineral estate; the right to transport or gather produced gas is not one of the five real property rights (or sticks) associated with a mineral estate under Texas law.
      - The Agreements do not include the language required under Texas law to effectuate a conveyance and the HPIP agreements include language expressly disclaiming any conveyance of an interest in Sabine's real property.

Sabine – Covenants Running with the Land (continued)

- Key Rulings in the March and May Decisions:
  - horizontal privity (continued):
    - Conveyance of a small surface tract for the construction of a gathering facility and the creation of a pipeline easement under the Nordheim Agreements did not establish horizontal privity.
  - The covenants do not "touch and concern" the land:
    - Judge Chapman noted that two tests exist under Texas law for determining whether a covenant touches and concerns land: (1) whether it impacts the nature, quality or value of the land or the mode of enjoying it, and (2) whether it affects or lessens the promisor's legal interest in the land.
    - Judge Chapman concluded that neither test was satisfied.
      - The covenants concern Sabine's interest in personal property – the produced/extracted products (oil and gas) – not real property.
      - The covenants do not affect Sabine's interest in real property.

Sabine – Covenants Running with the Land (continued)

- Key Rulings in the March and May Decisions:
  - If the covenants had satisfied the "touched and concerned" requirement, the conveyances effectuated by such covenants would have violated the terms of the Debtors' prepetition credit agreement.
  - The covenants did not burden or limit the use of the Debtors' mineral estates and, thus, can not run with the property as equitable servitudes.
    - An equitable servitude is enforceable if:
      - the contracting parties were in privity of estate on the conveyance date (*i.e.*, when the restriction was created);
      - a subsequent party purchased the land with notice of the restriction; and
      - the restriction at issue "concerns the land or its use or enjoyment."

Sabine – Appeal and Other Developments

- Nordheim and HPIP are appealing the March and May Decisions. They asked Judge Chapman to certify their appeals directly to the U.S. Court of Appeals for the Second Circuit; however, their requests were denied.
- After the May Decision was issued, Sabine sought, and obtained, authorization to enter into an agreement with DCP South Central Texas LLC that provides for the installation of DCP connection facilities; once the facilities are installed, Sabine will be able to connect directly into DCP's existing pipeline system.

Quicksilver Resources Inc., Case No. 15-10585 (Bankr. D. Del. 2015)

- Quicksilver Resources Inc. ("QRI") and its subsidiaries are engaged in the acquisition, exploration, development, and production of onshore oil and natural gas in North America.
- On March 17, 2015, QRI and certain of its subsidiaries (together with QRI, the "Quicksilver Debtors") filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code with the Bankruptcy Court for the District of Delaware.
- The Quicksilver Debtors sought to sell substantially all of their U.S. oil and gas assets through a section 363 sale process. The winning bidder for the assets conditioned its bid on the rejection of certain midstream agreements.
- The counterparties to these agreements filed a reservation of rights in connection with the hearing to approve the sale.
- The order approving the sale included "free and clear" provisions and language reserving the counterparties' rights to contest the proposed rejection of their agreements.

Quicksilver

- The Quicksilver Debtors filed a motion to reject the agreements. The non-debtor counterparties objected, arguing that the agreements were not subject to rejection because they contained non-severable covenants that run with the land.
  - The agreements included acreage dedications but no minimum volume commitments.
- On March 31, 2016, QRI issued an 8-K indicating that the buyer and QRI had extended the outside closing date for the sale "to provide additional time for the [b]uyer and [the counterparties] to enter into definitive gas gathering and processing contracts to replace certain existing executory contracts between certain of the [Quicksilver Debtors] and [the counterparties]."
- On April 6, 2016, the Quicksilver Debtors withdrew their motion to reject the midstream agreements with prejudice; the withdrawal became effective when the Quicksilver Debtors' received payment in full of the sale purchase price from the buyer.
  - The buyer and counterparties consented to the withdrawal of the rejection motion.

Other Midstream Agreement Rejection Disputes

- This issue has been raised in other cases as well:
  - *In re Magnum Hunter Resources Corp.*, 15-12533 (Bankr. D. Del. 2015)
    - Disputes arose regarding the Debtors' proposed rejection of certain gathering agreements. The parties ultimately settled and the Debtors assumed the agreements with certain modifications.
  - *In re Emerald Oil, Inc.*, Case No. 16-10704 (Bankr. D. Del. 2016)
    - On June 3, 2016, the Debtors commenced an adversary seeking a declaration that covenants and equitable servitudes (if any) contained in certain agreements do not run with the land.
      - Four agreements are at issue: (1) a Gas Gathering Agreement, (2) a Crude Oil Gathering Agreement, (3) a Water Gathering Agreement and (4) a Disposal Well Services Agreement.
      - The agreements are governed by North Dakota law.
  - *In re SandRidge Energy, Inc.*, Case No. 16-32488 (Bankr. S.D. Tex. 2016)
    - On June 6, 2016, the Debtors filed a motion seeking authority to reject a number of contracts, including a gas gathering agreement with Williams Midstream Gas Services ("Williams").
    - With respect to the Williams contract, the Debtors and Williams reached an agreement that the court would make no findings as to whether the covenants run with the land. Further, the parties reserved their rights to raise these issues as to other contracts between the Debtors and Williams. On June 30, 2016, the Court entered an order reflecting this agreement and authorizing rejection of certain contracts, including the Williams contract, *nunc pro tunc* to June 6, 2016.

Other Midstream Agreement Rejection Disputes (continued)

- *Penn Virginia Corporation*, Case No. 16-32395 (Bankr. E.D. Va. 2016)
  - On June 17, 2016, the Debtors filed an adversary complaint against Republic, the Debtors' midstream gathering and transportation provider, and filed a motion to reject its three agreements with Republic (the "Republic Agreements").
  - The Debtors argued, relying almost entirely on Judge Chapman's decision in *Sabine*, that the Republic Agreements do not contain covenants running with the land because the three elements necessary to establish a covenant running with the land are not present, namely, (1) the covenant at issue does not touch and concern the land; (2) there is no horizontal privity; and (3) the covenant at issues does not demonstrate intent to run with the land.
  - On July 18, 2016, the Debtors filed an 8-K announcing an agreement in principle, subject to definitive documentation and court approval, on the terms of amendments to the Republic Agreements and other issues related to the Debtors' chapter 11 cases.
    - The agreement provides, among other things, that (i) the Debtors' minimum volume commitment in each of the three Republic Agreements will be "substantially reduced" and (ii) Republic will receive an allowed general unsecured claim against its contract counterparty in the amount of $25 million.
  - On July 21, 2016, the Debtors filed a 9019 motion to settle certain disputes with Republic and to assume the amended Republic Agreements. The motion will be heard on August 4, 2016.

Index – Granting Language

- Sabine:
  - HPIP Gathering Agreements:
    - Producer hereby dedicates and commits to the performance of this Agreement the Leases and all of Producer's owned or controlled Production produced and saved from Producer's operated Wells located on the Leases, and to ensure the faithful performance of the provisions of this Agreement, Producer covenants to deliver the same to Gatherer at the CDPs listed on Exhibit C hereto without other disposition except as herein otherwise provided. This shall be a covenant attaching to and running with the lands and leasehold interests covered hereby and shall be binding on the successors and assigns of Producer[.]
  - Nordheim Gathering Agreements:
    - Shipper has dedicated for gathering and dehydration, and has agreed to deliver or cause to be delivered to Gatherer at the Receipt Points, the following . . . all Gas produced and saved on or after the Effective Date from wells now or hereafter located within the Dedicated Area or on lands pooled or unitized therewith, to the extent such Gas is attributable to the Interests within the Dedicated Area now owned, leased or hereafter acquired by Shipper and/or its Affiliates and their respective successors and assigns[.]

Index – Granting Language (continued)

- Quicksilver:
  - Subject to the terms and provisions hereof, Producer dedicates and agrees to deliver to Gatherer for gathering and to Processor for processing . . . the total volume of Gas owned or controlled by Producer or its successors and assigns, lawfully produced from wells now or hereafter drilled on the lands within the Contract Area or lands pooled therewith . . . Any transfer by Producer of its right, title, or interest in the Gas to a third party, whether by farmout, contract, or otherwise, shall be made specifically subject to this Agreement. Producer will notify any person to whom Producer transfers all or a portion of its right, title, or interest in the Gas that such Gas is dedicated pursuant to the terms of this Agreement to be gathered and processed in the Facilities, and Producer shall obtain such third party's agreement to continue delivering such Gas to Gatherer and Processor during the Term of and in accordance with this Agreement.

Index – Granting Language (continued)

- Emerald Oil:
  - [Debtor Parties will] deliver all of [the Debtor Parties'] Gas to [Midstream] at the Receipt Points without other disruption except as otherwise provided in this Agreement.
- Penn Virginia:
  - Shipper hereby dedicates and commits to Gatherer, in consideration for the gathering, trucking and delivery services to be provided by Gatherer hereunder, all of the Interests.

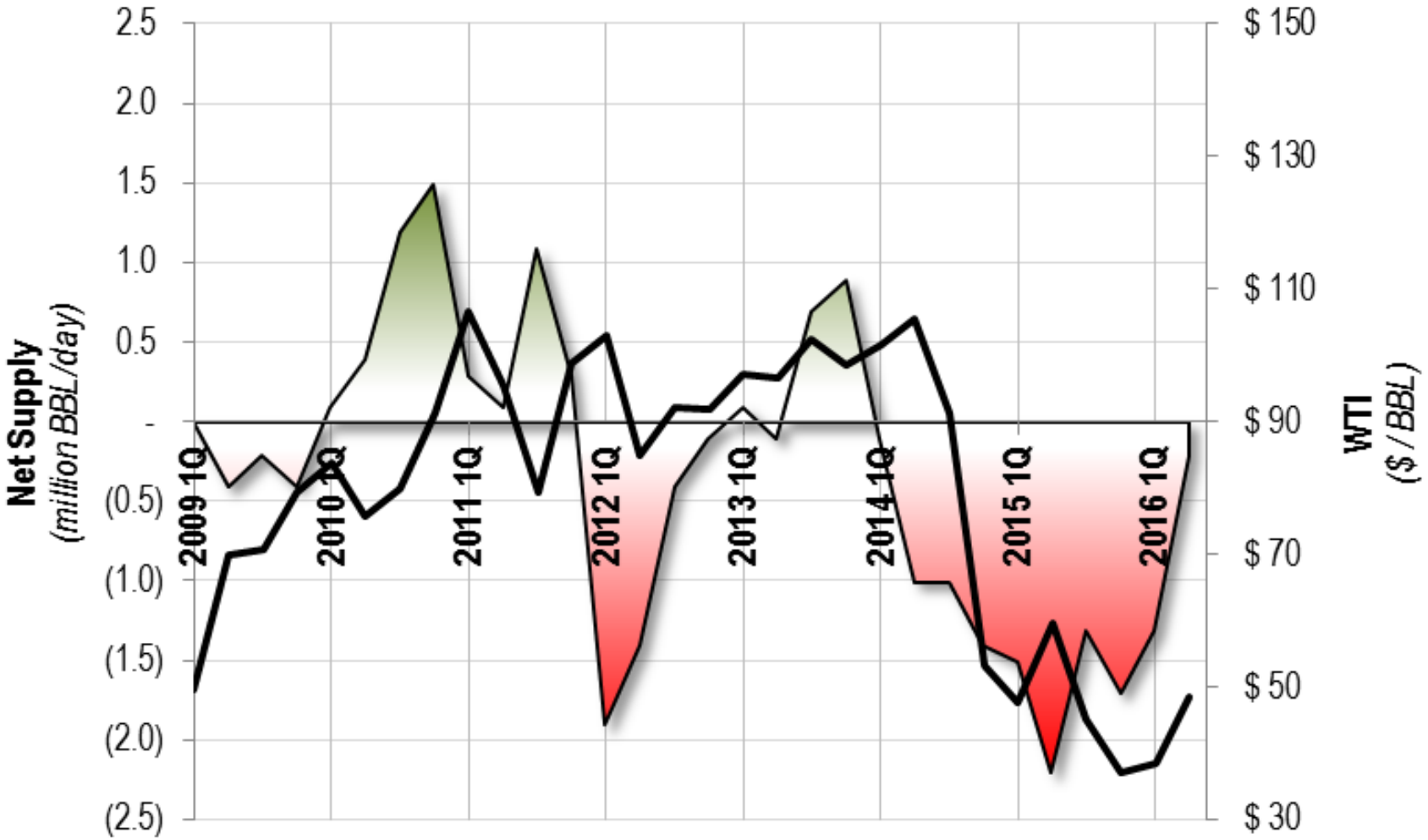
GAVIN/SOLMONESE

CREATING, PRESERVING & PROTECTING VALUE

ABI Mid-Atlantic
Oil & Gas Panel – Select Slides

DATE: July 27, 2016

Global Oil Markets:
Impact of Excessive Supply on WTI Pricing



US Oil & Gas:
ABLs & "Cash Grabs" [a]

The Study

- Reviewed 70 oil & gas companies that filed for chapter 11 since 2015

- RBLs / ABLs used by 25 debtors (with sufficient data disclosure)

- Reviewed two periods:
  - Initial "Baseline" Period, defined as:
    - No sooner than June 30, 2014 (i.e. after steep declines in energy prices)
    - Reflecting conditions either:
      - (i) Just prior to a cash grab; OR
      - (ii) If no sign of a cash grab, when the debtor's borrowing base was highest

  - Follow-up Period, defined as either:
    - Petition date; OR
    - If data not available from court filings, the most recent period pre-petition

[a] Cash Grab: an event where a borrower draws down on available credit to significantly grow cash balances; excludes situations were the debtor's cash balance returned to "normal" levels by petition date

US Oil & Gas:
ABLs & Cash Grabs

As expected, lenders have reduced borrowing bases and ABL capacity has been absorbed …

Borrowing Base Limit	Case Count [a]	ABL Borrowing Base [b] Initial Period	ABL Borrowing Base [b] Follow-up Period	ABL Borrowing Base [b] % Chng	ABL Capacity [c] Initial Period	ABL Capacity [c] Follow-up Period
		($ millions)			*(% of available capacity)*	
Less than $150m	8	$ 83.9	$ 55.5	*-34%*	27%	-6%
$150m to $500m	8	$ 276.2	$ 222.7	*-19%*	68%	12%
Over $500m	9	$ 1,893.8	$ 1,450.0	*-23%*	53%	14%

Source: *SEC filings, bankruptcy court filings, Gavin/Solmonese analysis*

[a] Jointly administered cases considered as a single case for statistical purposes

[b] Includes capacity for LOCs where data was available

[c] Total borrowings, including known commitments against LOCs divided by ABL borrowing base (see note [b])

Oil & Gas:
ABLs & Cash Grabs

… where cash grabs were present in cases where debtors had the largest ABL borrowing bases.

Borrowing Base Limit	Case Count [a] Total	Case Count [a] Cash Grabs	ABL Balance [b] Initial Period ($ millions)	ABL Balance [b] Follow-up Period ($ millions)	ABL Balance [b] % Chng	Cash Balance Initial Period ($ millions)	Cash Balance Follow-up Period ($ millions)	Cash Balance % Chng
Less than $150m	8	0	$ 64.5	$ 58.9	*-9%*	$ 6.9	$ 5.4	*-22%*
$150m to $500m	8	4	$ 89.1	$ 196.8	*121%*	$ 24.5	$ 101.8	*316%*
Over $500m	9	9	$ 825.9	$ 1,134.3	*37%*	$ 283.5	$ 579.2	*104%*

Source: *SEC filings, bankruptcy court filings, Gavin/Solmonese analysis*

[a] Jointly administered cases considered as a single case for statistical purposes

[b] Total borrowings, including known commitments against LOCs

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Dealing in Distressed Energy Assets

William Wallander, Katie Drell Grissel, Bradley Foxman, Garrick Smith, and Reese O'Connor[*]

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INTRODUCTION

Pricing volatility and business cyclicality in the energy sector periodically create the need for restructuring and reorganization.[1] A distressed energy company with excessive leverage or insufficient cash flow may pursue out-of-court or in-court asset sales to dispose of unprofitable or non-strategic assets, increase liquidity, and create operational efficiencies. Potential purchasers face differing benefits and risks when dealing in distressed assets depending on the specific circumstances in each transaction. This article generally focuses on the process of dealing in distressed assets in the energy space, with special focus on upstream assets, and reviews certain of the benefits and risks often encountered. Part I of this article will discuss out-of-court acquisitions from distressed sellers, and Part II will discuss acquisitions of distressed energy assets in bankruptcy.

I. OUT OF COURT ACQUISITIONS FROM DISTRESSED SELLERS

Acquisitions of assets from distressed energy sellers frequently occur out-of-court. This part will discuss the benefits and risks of such out-of-court transactions as compared to having such transactions approved as part of a bankruptcy proceeding.

A. The Benefit of Speed and Execution

The prompt execution of out-of-court asset purchases, with execution risk negotiated by the parties, potentially benefits buyers more than in-court sales. The sale of assets outside of the ordinary course of business in bankruptcy cases requires notice and a hearing before the sale can be approved and frequently involves parties with competing interests. These logistical hurdles often require additional time and impose potentially higher costs when compared to out-of-court transactions, particularly if the sale process is heavily contested and litigated. At the same time, as will be discussed further, *infra*, sales under court supervision can also proceed in a timely, negotiated manner, as is often the case when parties in interest seek the common goal of maximizing value through a transparent and vetted marketing process. Notwithstanding the benefit of expeditious execution in asset sales outside of bankruptcy, risks attendant to out-of-court sales by distressed entities exist, including potential allegations of fraudulent transfer and successor liability risk.

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1. *See* William Wallander *et al.*, *Energy Restructuring and Reorganization*, 10 TEX. J. OIL, GAS & ENERGY L. 1 (2014) [hereinafter Wallander] for a broader discussion on energy industry restructuring.

B. The Fraudulent Transfer Risk

In general, a "fraudulent transfer" (or "fraudulent conveyance") is a transfer of property made to another party either (1) with the actual intent to defer, hinder, delay, or defraud creditors (actual fraud), or (2) for less than reasonably equivalent value when the transferor is insolvent or has inadequate capital (constructive fraud). Both federal and state law provide avoidance actions and recovery remedies for fraudulent transfers based on actual or constructive fraud.

Under federal law, Bankruptcy Code § 548 provides that a transaction may be avoided for actual or constructive fraud if the transfer occurred within two years before the date of filing for bankruptcy.[2] Additionally, Bankruptcy Code § 544 allows trustees to bring fraudulent transfer actions based on actual or constructive fraud under state statutes.[3] All fifty states have laws prohibiting fraudulent transfers. While most states currently model such laws on the Uniform Fraudulent Transfer Act (UFTA), some still model their laws on the older Uniform Fraudulent Conveyance Act (UFCA). Still other states have recently updated their fraudulent transfer laws based on the Uniform Law Commission's 2014 amendments to UFTA, which renamed the Act the 2014 Uniform Voidable Transactions Act (UVTA).[4] The 2014 amendments, among other changes, incorporated choice of law rules and changed the statutory language to rid UVTA of any implication that constructively fraudulent transfers require fraud as opposed to statutory voidability.[5] As of March 2016, eight states—California, Georgia, Idaho, Kentucky, Minnesota, New Mexico, North Carolina, and North Dakota—have enacted UVTA, and four other states—Indiana, Iowa, Massachusetts, and Rhode Island—have, so far this year, introduced legislation seeking to do so.[6] Bankruptcy courts frequently view both federal and state law fraudulent transfer cases as persuasive precedent when interpreting fraudulent transfer statutes.[7]

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2. 11 U.S.C. §§ 548(a)(1)(A), (B) (2012).

3. 11 U.S.C. § 544.

4. For purposes of this Article, the phrase "uniform fraudulent transfer laws" refers to UFTA, UFCA, and UVTA collectively.

5. *See* UNIFORM VOIDABLE TRANSACTIONS ACT (FORMERLY UNIFORM FRAUDULENT TRANSFER ACT) (*as Amended in 2014*), Nat'l Conference of Comm'r on Unif. State Laws, *available at* http://goo.gl/eEQzSo (last visited March 23, 2016, 10:29 p.m.).

6. For a map of states that have enacted UVTA and states that have introduced legislation to adopt it this year, *see* the website for the Uniform Law Commission, *Voidable Transactions Act Amendments (2014) – Formerly Fraudulent Transfer Act*, *available at* http://goo.gl/5k8wIw(last visited March 23, 2016, 10:32 p.m.).

7. *See, e.g.*, *In re* Grandote Country Club Co., 252 F.3d 1146, 1152 (10th Cir. 2001).

Notably, many state statutes contain fraudulent transfer look-back periods beyond the Bankruptcy Code's two-year limitations period.[8] Under the version of UFTA adopted by most states, including Texas and Delaware, the limitations period for fraudulent transfers extends up to four years.[9] Under New York's version of UFCA, however, the limitations period spans up to six years after the conveyance.[10]

1. Actual Fraud: Federal and State Law

First, a trustee may avoid transfers made or obligations incurred by a debtor by establishing actual fraud. Broadly stated, to prove actual fraud under either Bankruptcy Code § 548 or state law enactments of the uniform fraudulent transfer laws, the trustee or debtor in possession must show that the debtor made the transfer or incurred the obligation "with actual intent to hinder, delay, or defraud" creditors.[11]

Bankruptcy courts often look for "badges of fraud" in determining whether a party possessed the requisite intent to constitute actual fraud.[12] The badges of fraud often comprise the following:

1) the transfer or obligation was to an insider;

2) the debtor retained possession or control of the property transferred after the transfer;

3) the transfer or obligation was concealed;

4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

5) the transfer was of substantially all of the debtor's assets;

6) the debtor absconded;

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8. 11 U.S.C. §§ 548(a)(1), (b) (2012) (permitting trustee to avoid any actual and constructive fraudulent transfers "made or incurred on or within 2 years before the date of the filing of the petition").

9. *See* TEX. BUS. & COM. CODE § 24.010 (1993) (setting forth the rule that, in order to commence a fraudulent transfer action beyond the four-year limit, the claim must be brought "within one year after the transfer or obligation was or could reasonably have been discovered by the claimant"); 6 DEL. CODE § 1309 (same).

10. N.Y. CODE § 213(8) ("[T]he time within which the action must be commenced shall be the greater of six years from the date the cause of action accrued or two years from the time the [claimant] discovered the fraud, or could with reasonable diligence have discovered it.").

11. 11 U.S.C. § 548(a)(1)(A).

12. *See, e.g.*, Williams v. Houston Plants & Garden World, Inc., 508 B.R. 11, 18–19 (Bankr. S.D. Tex. 2014) (citing *In re* Soza, 542 F.3d 1060, 1067 (5th Cir. 2008)).

7) the debtor removed or concealed assets;

8) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

10) the transfer occurred shortly before or shortly after a substantial debt was incurred; or

11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.[13]

Not all badges of fraud must be present for a bankruptcy court to find actual intent.[14] In fact, depending on the circumstances, a few badges may be sufficient to support a finding of actual fraud.[15]

2. Constructive Fraud: Federal and State Law

Next, if a trustee or debtor in possession is unable to establish actual fraud, it may nevertheless avoid transfers made or obligations incurred by a debtor under Bankruptcy Code § 548 by establishing constructive fraud (or voidability under UVTA). To prove constructive fraud under the Bankruptcy Code, the trustee or debtor in possession must show that the debtor received less than a "reasonably equivalent value" in exchange for such transfer or obligation, and that the debtor:

1) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

13. TEX. BUS. & COM. CODE § 24.005(b); 6 DEL. CODE § 1304(b). *See also* CAL. CIV. CODE § 3439.04(b).

14. *See In re* ASARCO L.L.C. v. Ams. Mining Corp., 396 B.R. 278, 371–72 (S.D. Tex. 2008) ("It is not necessary that all or any one of these badges of fraud support a finding of fraudulent intent; nor can one badge alone make out an inference of actual intent to hinder, delay, or defraud creditors. Rather, 'the confluence of several [badges of fraud] in one transaction generally provides conclusive evidence of an actual intent to defraud.'") (internal citations omitted).

15. *Id.*

2) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

3) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

4) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.[16]

The state law enactments of the uniform fraudulent transfer laws apply a similar standard to that in Bankruptcy Code § 548(a)(1)(B). In Texas, for example, a trustee may establish constructive fraud as to a creditor, whether the creditor's claim arose *before or within a reasonable time after* the transfer was made or the obligation was incurred, by showing that the debtor made the transfer or incurred the obligation without receiving "reasonably equivalent value" for the transfer or obligation and:

1) "was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction"; *or*

2) "intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due."[17]

Additionally, most state law enactments of the uniform fraudulent transfer laws—including the Texas statute—provide that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before such transfer or obligation if the debtor made the transfer or incurred the obligation "without receiving a reasonably equivalent value in exchange for the transfer or obligation" *and* "was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation."[18] As a further consideration, a transfer made by a debtor is deemed fraudulent as to a creditor whose claim arose before such transfer occurred if the transfer was (1) "made to an insider for an antecedent debt," (2) "the debtor was insolvent at that time," *and* (3) "the insider had reasonable

16. 11 U.S.C. § 548(a)(1)(B) (2012).
17. TEX. BUS. & COM. CODE § 24.005(a)(2).
18. *See* TEX. BUS. & COM. CODE § 24.006(a); 6 DEL. CODE § 1305(a); CAL. CIV. CODE § 3439.05.

cause to believe that the debtor was insolvent."[19]As will be shown in greater detail *infra*, constructive fraud determinations often hinge on whether "reasonably equivalent value" was exchanged, and disputes frequently arise regarding the value of the assets transferred in the challenged transaction.

3. Defenses and Mitigating Risk of Avoidance

In an effort to mitigate exposure to fraudulent transfer claims, a purchaser should be aware of the potential risks attendant to entering into a transaction with a distressed seller. Additionally, a purchaser should consider whether relevant facts satisfy the elements of the legal tests for actual or constructive fraud and, if so, whether any affirmative defenses are available. Bankruptcy courts often consider the non-exclusive list of "badges of fraud" discussed *supra* as indicia of an intent to hinder, delay, or defraud creditors when a trustee is seeking to establish actual fraud under Bankruptcy Code § 548(a)(1)(A) or applicable state law.[20] A purchaser should be aware of the badges of fraud and their applicability to the transaction at issue.

Further, parties frequently litigate voidability issues and disputes regarding whether reasonably equivalent value was given for the assets transferred. Inherent in transactions with distressed entities, a purchaser always bears the risk that a bankruptcy court will look back in time and determine that less than reasonably equivalent value was given in exchange for distressed assets. The Bankruptcy Code does not define reasonably equivalent value; rather, a bankruptcy court makes that determination on a fact-intensive, case-by-case basis.

Determining whether reasonably equivalent value was given in exchange for estate property requires valuation of the assets exchanged.[21] Bankruptcy courts possess wide latitude in determining whether to value assets at fair market value as opposed to liquidation value.[22] Indeed,

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19. *See* TEX. BUS. & COM. CODE § 24.006(b); 6 DEL. CODE § 1305(b).

20. *See, e.g.*, *ASARCO L.L.C.,* 396 B.R. at 371–72.

21. *See* 11 U.S.C. § 101(32) (2012) (establishing that the determination of a debtor's insolvency be made according to "fair valuation"); 11 U.S.C. § 506(a) (2012) (declaring that the value of a secured creditor's claim shall be "determined in light of the purpose of the valuation"); *In re* Heritage Highgate, Inc., 679 F.3d 132, 141 (3d Cir. 2012) ("Congress envisioned a flexible approach to valuation [under 11 U.S.C. § 506(a)] whereby bankruptcy courts would choose the standard that best fits the circumstances of a particular case.") (citing H.R. Rep. No. 95–595, at 356 (1977) ("Courts will have to determine the value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.").

22. *In re Heritage Highgate, Inc.*, 679 F.3d at 141.

valuing energy assets is a highly complex, yet inexact, science.[23] When faced with the difficult challenge of valuing energy assets, bankruptcy courts often use one of four valuation methods: (1) discounted cash flow, (2) comparable companies, (3) comparable transactions, or (4) market approach.[24]

Under the "discounted cash flow" (DCF) analysis, a company's future cash flow is projected and then discounted to present value utilizing the projected weighted average cost of capital.[25] Generally, a DCF analysis depends on three criteria: (1) the size of the expected future cash streams to be generated by the business; (2) the discount rate employed in determining the present value of such income streams; and (3) the terminal multiplier used to capture any residual value remaining in the business at the end of the projection period.[26] A company's past performance is commonly used to assess growth projections and estimates.[27] However, bankruptcy courts are not bound by specific metrics and are free to value assets based on the specific circumstances of each case. The further into the future a valuation extends, the more likely a bankruptcy court is to take a more conservative approach because time amplifies risk and unforeseeable contingencies.[28] Furthermore, courts are likely to shy away from more aggressive or selective valuations in contingent contexts.[29] As the energy industry continues to operate in new and remote locations, the process of calculating risks and estimating contingencies will continue to impact DCF analyses and create challenges in the valuation process.

By comparison, under the "comparable company" analysis, the relative value of peer companies is analyzed in order to determine the value of a debtor's assets. The comparable company valuation is comprised of two steps. First, the debtor's earnings before interest, taxes, depreciation, and amortization (EBITDA) is calculated. Then, in order to determine the debtor's value, "the multiple of a 'healthy' comparable company's market-assigned enterprise to its corresponding EBITDA" is

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23. *In re* Sherman, 157 B.R. 987, 989 (Bankr. E.D. Tex. 1993) ("No other area is more central to the bankruptcy process yet more perplexing to those practitioners and courts presented with its permutations than the question of valuation of assets.").

24. Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1, 16 (2012) (quoting *In re* Chemtura Corp., 439 B.R. 561, 573 (Bankr. S.D.N.Y. 2010) ("It is important to remember that bankruptcy judges have become familiar and comfortable with the DCF, comparable companies and comparable transactions methodologies. Indeed, these methods are often referred to as the 'standard' methodologies.") [hereinafter Sontchi]; *See also* VFB L.L.C. v. Campbell Soup Co., 482 F.3d 624, 633 (3d Cir. 2007).

25. Sontchi, *supra* note 24, at 7.

26. *In re* Cellular Info. Sys., Inc., 171 B.R. 926, 930 (Bankr. S.D.N.Y. 1994).

27. *See In re* Mirant Corp., 334 B.R. 800, 836 (Bankr. N.D. Tex. 2005).

28. *Id.* at 827–29.

29. *Id.*

calculated and multiplied by the debtor's EBITDA.[30] The comparable company analysis can be challenging; identifying comparable companies can be difficult because risk exposure and industry contingencies frequently distinguish seemingly comparable companies based on differences in industry, energy operation, and geographic location.[31]

Alternatively, the "comparable transaction" analysis considers recent transactions of similarly situated assets and companies, which are then extrapolated and applied to scale the value according to a debtor's relevant assets or enterprise value.[32] Ideally, the comparable transaction should be as recent in time as possible and take place within similar market conditions,[33] and the details of the transaction should be straightforward and accessible.[34] These considerations are especially important in the oil and gas industry given the movement of commodity prices.

Finally, when utilizing the "market approach" analysis, courts look to market evidence and other economic indicators to assess the total capital value of a debtor and its assets.[35] The market value of a debtor may be estimated by looking to the stock or bond market price of a debtor's securities.[36] Despite its functionality, bankruptcy courts have expressed concerns regarding market value analysis, including: (1) the impact of "taint" or "stigma" of bankruptcy on an asset's price due to the market's

30. Kerry O'Rourke, *Valuation Uncertainty in Chapter 11 Reorganizations*, 2005 COLUM. BUS. L. REV. 403, 420 (2005).

31. *See In re Mirant Corp*., 334 B.R. at 837–38.

32. *See* Sontchi, *supra* note 24, at 12–13.

33. *In re* Genco Shipping & Trading Ltd., 513 B.R. 233, 253 (Bankr. S.D.N.Y. 2014); *In re* Chemtura Corp., 439 B.R. at 585 ("I find that the [compared] transaction was indeed the most appropriate comparable transaction, both by nature of company being acquired and in time."); *In re* Exide Techs., 303 B.R. 48, 62–63 (Bankr. D. Del. 2003) (refusing to compare transactions in an industry where the market changed considerably from 1998 to 2002).

34. *See In re Chemtura Corp*., 439 B.R. at 585–86 (noting that the transaction does not need to be closed to be considered under this analysis if sufficient documentation is available).

35. *See* VFB L.L.C. v. Campbell Soup Co., 482 F.3d at 632–33; U.S. Bank Nat'l Ass'n. v. Verizon Commc'ns. Inc., 892 F. Supp. 2d 805, 808–14 (N.D. Tex. 2012).

36. *VFB L.L.C.*, 482 F.3d at 633 ("[A]bsent a compelling reason to distrust it, the market price is 'a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses.'") (citing *In re* Prince, 85 F.3d 314, 320 (7th Cir. 1996)).

tendency to irrationally undervalue distressed assets and companies;[37] (2) the uncertainties a bankruptcy case may create in valuing an already complex asset;[38] and (3) the existence of fraud or concealment of material information to the market.[39] Nonetheless, the trend among bankruptcy courts is to apply greater scrutiny when a party suggests a valuation that differs from the valuation derived via an active and discernible market.[40]

As part of the valuation process, parties often retain third party experts or consultants to evaluate energy transactions with distressed entities. Because valuation of energy assets is highly situational, bankruptcy courts must frequently make determinations based upon "battle[s] of the experts." Notably, bankruptcy courts have favored experts with real experience in the energy field, even if an expert lacks an advanced degree.[41]

Another defense strategy may be to argue solvency of the transferor at the time of the transfer. A "solvency opinion" or "valuation opinion" from a third party expert can support a buyer's valuation position and may help mitigate the risk that a party will bring an avoidance action to claw back the assets.[42] Further, in public company scenarios, securities trading values indicative of solvency can be utilized.[43] A third party "fairness opinion," which states that the transaction was done fairly both procedurally and substantively, may also support a buyer's valuation position.

Certain transfers can be defended from voidability if the transferee acted in "good faith" and the transfer was "for value" under applicable federal or state fraudulent transfer law. Bankruptcy Code § 548(c) provides that "a

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37. *In re Mirant Corp.*, 334 B.R. at 834–35; *see also In re* Penn Cent. Transp. Co., 596 F.2d 1102, 1115 (3d Cir. 1979) (recognizing that, in some instances, "evidence of market value should be ignored because the market can be expected irrationally to undervalue the securities of a once-distressed company emerging from a lengthy reorganization"); *In re* New York, N.H. & H. R.R. Co., 4 B.R. 758, 792 (D. Conn. 1980) ("The stigma of bankruptcy alone is a factor that will seriously depress the market value of a company's securities."); *In re* Missouri Pac. R.R. Co., 39 F. Supp. 436, 446 (E.D. Mo. 1941) ("[The] debtors have been in the process of reorganization for eight years, which fact alone would necessarily result in a serious depression in the market value of its securities.").

38. *In re Mirant Corp.*, 334 B.R. at 834.

39. *See* Tronox Inc. v. Kerr McGee Corp. (*In re* Tronox Inc.), 503 B.R. 239, 298–303 (Bankr. S.D.N.Y. 2013) (indicating that market valuation was not indicative of value where the information was obscured).

40. *See, e.g.*, *U.S. Bank Nat'l Ass'n.*, 892 F. Supp. 2d at 808–14; *VFB L.L.C.*, 482 F.3d at 632–33.

41. Floyd v. Hefner, 556 F. Supp. 2d 617, 639 (S.D. Tex. 2008) ("[The expert's] lack of a formal accounting degree does not disqualify his opinions in this case given the level of his professional experience in [the oil and gas] field.") (citing S. Cement Co. v. Sproul, 378 F.2d 48, 49 (5th Cir. 1967)).

42. *See In re Tronox Inc.*, 503 B.R. at 301–03.

43. Trustee of the Idearc Inc. Litigation Trust v. Verizon Commc'ns. Inc. (U.S. Bank Nat'l Assn. Litigation), 817 F. Supp. 2d 934 (N.D. Tex. 2011); Statutory Comm. of Unsecured Creditors v. Motorola, Inc. *(In re* Iridium Operating L.L.C.), 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred" to the extent the transferee or obligee exchanged value for such transfer or obligation.[44] Similarly, UFTA, as adopted by Texas and Delaware, provides that a transfer or obligation is not voidable against a person who took in good faith for reasonably equivalent value.[45] The valuation methods discussed *supra* also come into play with respect to the value prong of this defense. As to whose perspective will determine value in the context of this affirmative defense (i.e., the transferee's or the creditor's), the result may vary depending upon whether Bankruptcy Code § 548(c) or state law is applied.[46]

4. Recovery of Assets Transferred or the Value Thereof

Once a transaction has been avoided, both the Bankruptcy Code and state law grant a trustee the power to recover fraudulently transferred assets, or the value of those assets, for the benefit of the bankruptcy estate.[47] Specifically, Bankruptcy Code § 550 provides that a trustee may recover the transferred property or its value from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee."[48]

A good faith purchaser or transferee holds a lien on the property to secure the value of any "improvements" made to the property after the transfer.[49] Additionally, an action for recovery may not be brought after the earlier of (1) one year after the avoidance of the transfer under bankruptcy law, or (2) the time the bankruptcy case is closed or dismissed.[50]

Similar to the standard set forth in § 550, many state fraudulent transfer statutes provide a comparable recovery standard. For example, Texas law provides that, to the extent a transfer is voidable, a creditor may recover the

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44. 11 U.S.C. § 548(c) (2012).

45. TEX. BUS. & COM. CODE ANN § 24.009(a) (2015); 6 DEL. CODE ANN. tit. § 1308(a) (2015).

46. *Cf.* Janvey v. Golf Channel, Inc., 780 F.3d 641 (5th Cir. 2015) *with* Williams v. FDIC (*In re* Positive Health Mgmt.), 769 F.3d 899 (5th Cir. 2014), *and* Jimmy Swaggart Ministries v. Hayes (*In re* Hannover Corp.), 310 F.3d 796 (5th Cir. 2002).

47. 11 U.S.C. § 550(a); *See also* 11 U.S.C. § 550(d) ("The trustee is entitled to only a single satisfaction . . . .")

48. 11 U.S.C. § 550(a). However, Bankruptcy Code § 550(b) provides that for any immediate or mediate transferee of such initial transferee under Bankruptcy Code § 550(a)(2), the trustee may not recover from: "(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or (2) any immediate or mediate good faith transferee of such transferee." 11 U.S.C. § 550(b).

49. 11 U.S.C. § 550(e).

50. 11 U.S.C. § 550(f).

lesser of the value of the asset transferred or the amount of the creditor's claim against: "(1) the first transferee of the asset or the person for whose benefit the transfer was made; or (2) any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee."[51] Additionally, Texas law provides that if the creditor's recovery is based on the value of the asset transferred, the value is calculated as of the time such asset is transferred, subject to equitable adjustment as necessary.[52]

5. Examples of Recent Fraudulent Actions

Recent examples of fraudulent transfer actions help illustrate the application of fraudulent transfer laws.[53] For example, in its 2008 decision in *In re ASARCO*, the District Court for the Southern District of Texas considered whether a transaction, by which a parent company received a transfer of the "crown jewel" asset of its subsidiary, constituted an actual or constructive fraudulent transfer.[54] The plaintiffs, ASARCO (a copper mining company) and its wholly-owned subsidiary, sued the debtor's parent corporation, Americas Mining Corporation (AMC), claiming that AMC's transfer of Southern Peru Copper Company's (SPCC) stock constituted a fraudulent transfer.[55] ASARCO had directly held a majority ownership interest in SPCC, which was a very profitable company.[56] However, when AMC acquired ASARCO, AMC directed that the SPCC stock be transferred to a subsidiary wholly-owned by ASARCO, Southern Peru Holding Company (SPHC), which ASARCO alleged had been set up by AMC as a sham entity in order to hold the SPCC stock—allowing for pledging of the stock as loan collateral while also removing it from the reach of ASARCO's creditors.[57] Notably, the stock removal occurred after AMC bought ASARCO without completing full due diligence, thereafter discovering ASARCO's substantial environmental liabilities.[58] Subsequently, AMC caused SPHC to transfer its shares in SPCC to AMC.[59] The court pierced the veil between SPHC and ASARCO so that ASARCO could challenge the transfer of the SPCC stock to AMC as a fraudulent transfer of property of ASARCO.[60]

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51. TEX. BUS. & COM. CODE § 24.009(b).
52. TEX. BUS. & COM. CODE § 24.009(c)(1). Texas law also provides that courts are not to adjust the value of the assets transferred to include the value of improvements made by a good faith transferee. TEX. BUS. & COM. CODE § 24.009(c)(2).
53. In addition to the two prominent cases discussed in this section, see Appendix A for further examples of key fraudulent transfer cases.
54. *ASARCO L.L.C.*, 396 B.R. at 299–315.
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *ASARCO L.L.C.*, 396 B.R. at 335.

The plaintiffs asserted actual and constructive fraudulent transfer claims pursuant to Bankruptcy Code § 548 and the Delaware fraudulent transfer statute.[61] Regarding constructive fraud, the court looked to Delaware law and analyzed whether "reasonably equivalent value" was transferred for the SPCC stock transfer.[62] The court analyzed each aspect of consideration for the stock transfer, applying a market valuation with consideration of stock price, a comparable company analysis, and a discounted cash flow analysis in order to value the stock.[63] After completing its valuation, the court found that, under the totality of the circumstances, ASARCO received eighty-five to ninety percent of the SPCC stock's value, which constituted "reasonably equivalent value."[64] Accordingly, the plaintiffs' constructive fraudulent transfer claim failed.[65]

However, as to actual fraud, the court considered whether the SPCC stock transfer was made with the "actual intent to hinder, delay or defraud any creditor of the debtor" under Delaware law and Bankruptcy Code § 548.[66] As a threshold matter, the court found that, while the debtor must be the party who transfers with the intent to hinder, delay, or defraud creditors, AMC possessed the requisite domination and control of ASARCO such that actual fraudulent intent could be imputed to it.[67] Next, the court examined the statutory "badges of fraud" and other salient factors based on "all surrounding facts and circumstances."[68] The court found actual fraud based on intent to hinder and delay, particularly because AMC did not properly market the stock to the highest bidder, removed the "crown jewel" asset from the estate, concealed and altered information, broke promises to ASARCO's independent directors, and closed the transaction over the objections of the independent directors with knowledge that the transaction would hinder and delay the debtor

61. *Id.* at 335–94.
62. *Id.*
63. *Id.* at 342–64.
64. *Id.* at 364.
65. *Id.*
66. *ASARCO L.L.C.*, 396 B.R. at 364–65.
67. *Id.* at 369–70.
68. *Id.* at 370–80.

paying other creditors.[69] The court ultimately entered a judgment against AMC valued at over $6 billion.[70]

In another example, *In re Tronox*, the Bankruptcy Court for the Southern District of New York considered whether the spin-off of a profitable portion of a parent company's business that left the parent with substantial liabilities constituted an actual or constructive fraudulent transfer under the Oklahoma fraudulent transfer statute.[71] In this case, Old Kerr-McGee (later renamed "Tronox") was an energy company with a wide range of energy and chemical operations.[72] After a spinoff in 2006, Tronox retained substantial legacy environmental and tort liabilities that accrued over the course of seventy years, while the valuable oil and gas exploration and production business was transferred into the newly-formed New Kerr-McGee.[73] A few months after the spinoff, Anadarko Petroleum purchased New Kerr-McGee's recently acquired exploration and production business for $18 billion;[74] Tronox subsequently filed for bankruptcy on January 12, 2009.[75]

Regarding actual fraud, the court applied the Oklahoma fraudulent transfer statute, which provides a four year statute of limitations for fraudulent transfer claims.[76] The court distinguished between "intent to defraud" and "intent to hinder or delay" and found legally sufficient grounds to impose fraudulent transfer liability where defendants acted with the mere purpose or "intent to hinder and delay" creditors.[77] The court concluded that separating the E&P business and assets from the legacy liabilities was a primary driver in the spinoff and that the parties understood the adverse impact on Tronox's creditors.[78] Further, the court found evidence of "badges of fraud," including: (1) transfers among insiders; (2) retention of control of transferred assets; (3) "ineffective and

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69. *Id.* at 386–94.

70. According to the law firm representing ASARCO as debtor in possession, the value of the judgment exceeded $6 billion. *See* News Release, Baker Botts, Federal District Judge Awards ASARCO Damages Estimated at More Than $6 Billion, *available http://www.bakerbotts.com/news/2009/04/federal-district-judge-awards-asarco-damages-est* (last visited May 11, 2015). Some estimates of the value of the judgment range as high as $10 billion. *See, e.g.*, ASARCO L.L.C. v. Baker Botts, L.L.P. (*In re* ASARCO, L.L.C.), 751 F.3d 291, 293 (5th Cir. 2014), *cert. granted on other grounds*, 135 S.Ct. 44 (Oct. 2, 2014) (No. 14-103).

71. *In re Tronox Inc.*, 503 B.R. at 248–52.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at 262–63.

76. *Id.* at 277.

77. *Id.* at 277–79 ("The *ASARCO* Court could also have cited *Shapiro v. Wilgus*, where the Supreme Court made it clear that the debtor's scheme did not have to be undertaken for nefarious or malicious purposes but merely with the purpose of hindering or delaying creditors.") (internal citations omitted).

78. *In re Tronox Inc.*, 503 B.R. at 280.

insubstantial" disclosure of transfers in SEC filings; (4) threats of litigation regarding legacy liabilities prior to the transactions; and (5) the transfer for substantially all of Tronox's assets.[79]

In the end, the court found unpersuasive the defendants' argument that a "legitimate supervening cause" for the transfer aimed at "unlocking" the chemical business existed.[80] Further, the court rejected the defense that the defendants believed Tronox would remain solvent and be able to continue to pay debts as they became due.[81] Instead, the court stated, the "real question is whether the [d]efendants had a good faith belief that Tronox would be able to support the environmental and other legacy liabilities that had been imposed on it."[82] Thus, the court concluded that actual intent to delay or hinder creditors had been established such that the spinoff constituted an actual fraudulent transfer under Oklahoma law.[83]

Regarding constructive fraud, the court again applied the Oklahoma fraudulent transfer statute. The court, by considering all related transactions together as a single transaction, found that Tronox did not receive "reasonably equivalent value" in the transaction.[84] The court also analyzed market evidence, contingent liabilities, and asset valuation.[85] While the defendants presented market evidence—including a successful initial public offering and an offer from a private equity firm to purchase Tronox's chemical business—the court rejected the market-based arguments, finding that the plaintiff's expert demonstrated that the numbers were inflated and "the financial statements on which the market relied were false and misleading."[86] The court put particular emphasis on valuing the environmental and tort liabilities, and it generally found the plaintiffs' experts to be more credible and the liabilities to be substantial.[87] Finally, in analyzing Tronox's business enterprise value, the court applied three different valuation methods to determine business enterprise value—discounted cash flow analysis, comparable company analysis, and comparable transaction analysis.[88] Based on numerous factors, the court found that Tronox was insolvent and unreasonably capitalized, and that the defendants reasonably should have believed that Tronox would be

79. *Id.* at 282–85.
80. *Id.* at 285–89.
81. *Id.* at 285.
82. *Id*.
83. *Id.* at 288–91.
84. The court found that Tronox transferred property worth $17 billion ($15.8 billion in exploration and production assets) for only $2.6 billion in return. *In re Tronox Inc*., 503 B.R. at 291–95.
85. *Id.* at 297.
86. *Id.* at 298–99.
87. *Id.* at 309–15.
88. *Id.* at 316–20.

unable to pay its debts as they became due.[89] Thus, constructive fraud was also established under Oklahoma law, and the defendants were held liable for billions of dollars owed to the bankruptcy estate. On January 23, 2015, the parties finalized a settlement agreement, wherein the defendants agreed to pay $5.15 billion, plus interest, to resolve the fraudulent transfer claims.[90]

C. Successor Liability and Bankruptcy Filing Risks

When a purchaser buys distressed assets outside of bankruptcy, the purchaser does not receive the assets "free and clear" of existing liens, claims, and encumbrances in the same manner as it would in a sale approved in a bankruptcy court proceeding. Instead, lien releases must be obtained, which may require significant diligence and expense and could create substantial delay. Without lien releases, a purchaser could face third party claims that would interfere with the purchaser's uninhibited use and right to the acquired assets.

Further, when engaging in out-of-court transactions, a party is faced with contractual restrictions, including anti-assignment provisions, consent rights, and rights of first refusal that may belong to third parties and may adversely impact an out-of-court transaction. Many contracts contain specific clauses granting third parties rights of consent or refusal that limit free assignability of certain assets or interests. While in the bankruptcy process a party need not always comply with contractual provisions restricting assignment, parties transacting outside of bankruptcy typically must comply with these provisions before transferring assets or interests to a third party. Such restrictive provisions can be problematic for a purchaser and can often disrupt the out-of-court sale process.

If a seller files for bankruptcy after signing a purchase agreement but before closing the transaction, a purchaser may find its transaction at risk due to a debtor's rights under Bankruptcy Code § 365 to reject the sale agreement as an executory contract. Also, if there are multiple related acquisition agreements, a debtor may seek to "cherry pick" acquisition agreements that it finds beneficial to assume and reject those it finds burdensome. Such cherry-picking could have the effect of materially and negatively affecting the overall economics of the transaction. If an agreement is rejected, the debtor will have no further performance

89. *Id.* at 315–24.

90. Press Release, The U.S. Dep't of Justice, Historic $5.15 Billion Environmental and Tort Settlement with Anadarko Petroleum Corp. Goes into Effect (Jan. 23, 2015), *available at* http://www.justice.gov/opa/pr/historic-515-billion-environmental-and-tort-settlement-anadarko-petroleum-corp-goes-effect-0 (last visited May 15, 2015, 10:30 a.m.).

obligations, and the purchaser is entitled to assert a damages claim. In the event the transaction closes prior to a bankruptcy filing, a purchaser may also be left without enforceable warranties, representations, and indemnities under the terms of the agreement. Additionally, purchasers may find that certain payments made before closing, such as true-up payments or purchase price adjustments, may be challenged as avoidable preferences that may be recoverable by the bankruptcy estate. Tactics to mitigate risks in out-of-court transactions include negotiating contractual terms that take into account risks such as: (1) providing for a portion of the purchase price to be placed in escrow or otherwise reserved pending resolution of certain risks and contingencies; (2) obtaining liens on the distressed seller's assets to secure a party's obligations; or (3) integrating transaction contracts expressly and substantively to guard against a debtor's ability to "cherry pick," or reject some agreements while assuming others.

II. ACQUISITIONS OF DISTRESSED ENERGY ASSETS IN BANKRUPTCY

Given the potential risks for out-of-court transactions, a buyer considering a purchase of distressed assets out-of-court, alternatively, may consider a bankruptcy court-approved sale process. This part examines key facets of the options available in bankruptcy proceedings.

A. The 363 Sale Free and Clear of Claims and Interests

Purchasing energy assets in a bankruptcy process under Bankruptcy Code § 363 offers certain advantages over other types of out-of-court transactions. A § 363 asset sale affords the purchaser statutory protections and rights not found in an out-of-court transaction, typically involves less time, and does not require adherence to the procedural formalities otherwise required for a sale under a plan of reorganization. Perhaps most importantly, sales under Bankruptcy Code § 363 allow purchasers to take the assets "free and clear" of most claims, liens, and other interests.

Bankruptcy court approval is required for asset sales under Bankruptcy Code § 363 (as opposed to out-of-court transactions), and the bankruptcy court has broad discretion in deciding whether to authorize a Bankruptcy Code § 363 asset sale. Regular business transactions that occur on a day-to-day basis, however, are considered part of a debtor's "ordinary course of business" and do not require bankruptcy court approval. For example, a natural gas exploration and production company may continue to sell the gas it has produced in the ordinary course of business without

notifying creditors or obtaining court approval.[91] By comparison, a sale of all or substantially all of a debtor's assets would constitute an "outside-the-ordinary-course" transaction requiring notice to parties in interest and bankruptcy court approval.[92]

In order to determine whether a particular use or sale of property falls within a debtor's ordinary course of business, bankruptcy courts generally apply a horizontal dimension test and a vertical dimension test.[93] Under the horizontal dimension test, bankruptcy courts look to whether the transaction at issue is one that would normally be entered into by similar businesses.[94] Under the vertical dimension test, courts look to whether the proposed transaction exposes the debtor's creditors to a different economic risk than that which would have been expected in the past (i.e., whether the proposed transaction is consistent with the debtor's past behavior).[95]

Historically, courts were reluctant to authorize asset sales in Chapter 11 bankruptcy cases absent sufficiently compelling circumstances, under the rationale that Chapter 11 is designed to reorganize a debtor's affairs, not liquidate its assets. Today, however, asset sales under Bankruptcy Code § 363 are fairly common in Chapter 11 cases. Bankruptcy courts can permit outside-the-ordinary-course asset sales under § 363 if the debtor demonstrates a sound business justification for the sale.[96] Even courts that are more hesitant to authorize § 363 sales will permit them in certain situations, including those where: (1) a company's going concern value[97] is declining and financing is contingent on a speedy sale; (2) a company

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91. Importantly, any party with an interest in the property to be used or sold may petition the bankruptcy court to prohibit or condition the debtor's use or sale of the property to the extent necessary to provide adequate protection of that party's interest. 11 U.S.C. § 363(e) (2012).

92. 11 U.S.C. § 363(b)(1).

93. *See In re* Roth Am., Inc., 975 F.2d 949, 952 (3rd Cir. 1992) (citing Benjamin Weintraub & Alan N. Resnick, *The Meaning of "Ordinary Course of Business" Under the Bankruptcy Code—Vertical and Horizontal Analysis,* 19 UCC L. J. 364 (1987)); Burlington Northern R.R. Co. v. Dant and Russel, Inc. (*In re* Dant and Russel, Inc.), 853 F.2d 700, 704 (9th Cir. 1988); Braunstein v. McCabe, 571 F.3d 108, 124 (1st Cir. 2009); Denton County Elec. Coop. v. Eldorado Ranch, Ltd. (*In re* Denton Cnty. Elec. Coop.), 281 B.R. 876, 882 n.12 (Bankr. N.D. Tex. 2002); Sunshine Heifers, L.L.C. v. Moohaven Dairy, L.L.C., 13 F. Supp. 3d 770, 775 (E.D. Mich. 2014).

94. *In re Roth Am., Inc.*, 975 F.2d at 953.

95. *Id*.

96. *See, e.g.*, *In re* Georgetown Steel Co., L.L.C., 306 B.R. 549, 555 (Bankr. D.S.C. 2004) ("Courts often review a debtor's use, sale or lease of property of the estate outside of the ordinary course of business pursuant to the debtor's demonstration of a sound business purpose.") (citations omitted); *In re* Enron Corp., No. 01-16034, 2003 WL 1562202, at *19 (Bankr. S.D.N.Y. Mar. 21, 2003) (citing *In re* Chateaugay Corp., 973 F.2d 141 (2d Cir. 1992)).

97. A "going concern value" is the value of a company as an ongoing entity, as contrasted to the value of the company's assets were the company to be liquidated.

would otherwise lose valuable customers absent an expedited sale; (3) a company's business depends on trade credit; or (4) a company's operating expenses exceed revenues.[98]

While the modern trend is to use the § 363 sale process as a potential end-goal of complex reorganizations,[99] some courts will not approve such a sale if it is determined to be a *sub rosa*, or secret, plan. A *sub rosa* plan is a disguised Chapter 11 plan of reorganization designed to evade compliance with proper plan procedures;[100] *sub rosa* plans are impermissible because they "short circuit" the Bankruptcy Code's requirements for plan confirmation.[101] As a result, bankruptcy courts scrutinize § 363 sales to ensure they do not improperly affect plan confirmation protections like creditor priorities. For example, the Fifth Circuit declined to authorize a proposed asset sale in *In re Braniff Airways*.[102] In that case, the assets proposed to be sold were plane landing slots that comprised a significant portion of the debtor's total assets.[103] Further, the sale agreement effectively established the terms of a Chapter 11 plan by, *inter alia*, requiring secured creditors to vote in favor of a subsequent plan of reorganization and releasing all claims against the debtor.[104] In practice, *sub rosa* objections are generally not successful unless the evidence points to a short-circuiting of the plan process by secretly establishing what should be terms of a plan in connection with the sale of assets.

1. General Requirements for Sale Approval

Under the first prong of the § 363 sale analysis, bankruptcy courts commonly conduct a four-factor inquiry examining: (1) whether the debtor has articulated a sound business purpose for the sale, (2) whether

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98. *See* Wachtell, Lipton, Rosen & Katz, *Distressed Mergers and Acquisitions*, at 50–52 (2013), *available at* http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.22377.13.pdf (last visited May 15, 2015, 10:32 a.m.) (hereinafter referred to as "Wachtell") (citing *In re* Chrysler L.L.C., 576 F.3d 108 (2d Cir. 2009), *aff'g In re* Chrysler L.L.C., 405 B.R. 84 (Bankr. S.D.N.Y. 2009); *In re* Gen. Motors Corp., 407 B.R. 463, 491-92 (Bankr. S.D.N.Y. 2009); *In re* Boston Generating, L.L.C., 440 B.R. 302, 329 (Bankr. S.D.N.Y. 2010)).

99. *See* Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J. L. BUS. & FIN. 258, 262–94 (2012).

100. *In re* Gulf Coast Oil Corp., 404 B.R. 407, 416-18 (Bankr. S.D. Tex. 2009); Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983).

101. *In re Braniff Airways, Inc*., 700 F.2d at 939–40.

102. *Id.* ("The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with the sale of assets.").

103. *Id.*

104. *Id.*

the offer is fair and reasonable, (3) whether adequate and reasonable notice has been given, and (4) whether the parties acted in good faith.[105]

a. Respect of the Debtor's Business Judgment

Bankruptcy courts generally apply a "business judgment test" to determine whether a sound business-related purpose underlies a proposed outside-the-ordinary-course asset sale such that it should be authorized.[106] In assessing the soundness of a debtor's business decision to sell its assets outside of the ordinary course of business, bankruptcy courts commonly consider factors such as:

1) the proportionate value of the asset to the estate as a whole;

2) the amount of time elapsed since the filing;

3) the likelihood that a plan of reorganization will be proposed and confirmed in the near future;

4) the effect of the proposed disposition on future plans of reorganization;

5) the proceeds to be obtained from the disposition regarding appraisals of the property;

6) which of the alternatives of use, sale, or lease the proposal envisions;

7) the estate's liquidity until confirmation of a plan;

8) alternative sales options at the time of confirmation; and

9) whether the assets to be sold are increasing or decreasing in value.[107]

b. The Need to Be Fair and Reasonable

While bankruptcy courts place great emphasis on the business judgment prong of the test, a debtor must also establish that the price and

105. *In re* Exaeris Inc., 380 B.R. 741, 744 (Bankr. D. Del. 2008) (citing *In re* Del. & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991)); *see also* Sugarloaf Indus. & Mktg. Co. v. Quaker City Castings, Inc. (*In re* Quaker City Castings, Inc.), 2005 Bankr. LEXIS 2211, at *22-24 (B.A.P. 6th Cir. Nov. 18, 2005).

106. *See In re* Lionel Corp., 722 F.2d 1063, 1070 (2d Cir. 1983); Stephens Indus., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986); *In re Quaker City Castings, Inc.*, 2005 Bankr. LEXIS 2211, at *22–24.

107. *See, e.g.*, *In re* Cont'l Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) (citing *In re Lionel Corp*., 722 F.2d at 1071).

terms of the sale agreement are "fair and reasonable."[108] Whether the terms of a proposed sale are fair and reasonable depends on the circumstances of each case.[109] A debtor properly marketing or "shopping" assets will increase the likelihood that a bankruptcy court will find a proposed sale price to be fair and reasonable. Further, while the Bankruptcy Code does not require sale by auction, debtors frequently sell their assets by auction because the auction process is considered an effective means of effectuating a fair arm's-length transaction.[110] Notably, if an insider or fiduciary of the debtor is purchasing assets from the debtor, bankruptcy courts apply a heightened standard of review, discussed *infra*, to ensure the sale price is fair and reasonable.[111]

c. The Need for Adequate and Reasonable Notice of the Sale

In addition to the requirements that a sale be fair, reasonable, and supported by a sound business justification, the debtor must further be sure to provide proper and adequate notice of its proposed asset sale. Bankruptcy courts will not authorize a sale under Bankruptcy Code § 363 unless the debtor provides sufficient notice to parties in interest, such that all parties have a meaningful opportunity to respond and object to the proposed sale, if warranted.[112] As a general rule of thumb, a debtor must give creditors and parties in interest at least twenty-one days' notice of the proposed sale, unless the court shortens the required notice period.[113]

d. The Need for Good Faith of the Debtor and Prospective Buyer

Lastly, the asset sale must be proposed in "good faith." When assessing the good faith of a proposed sale, bankruptcy courts commonly

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108. *See, e.g.*, *In re* Reese, No. 06–50133–RLJ–11, 2006 WL 6544094, at *4–5 (Bankr. N.D. Tex. July 11, 2006).

109. *Id.*

110. Rule 6004(f) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") provides that sales not in the ordinary course of business may be either by private sale or by public auction. FED. R. BANKR. P. 6004(f).

111. *In re* Mallory Co., 214 B.R. 834, 837–38 (Bankr. E.D. Va. 1997).

112. *See, e.g.*, *In re* Naron & Wagner, Chartered, 88 B.R. 85, 89 (Bankr. D. Md. 1988) (The debtor "must provide notice to all parties in interest . . . to [sufficiently] inform [them] of the anticipated impact of the sale on debtor's business and/or anticipated plan. For example, . . . the notice should contain enough information to alert interested parties that this is their last chance to be heard.").

113. *See* FED. R. BANKR. P. 2002(a)(2) (requiring at least twenty-one days' notice of a proposed sale of property of the estate "other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice"). Some local rules vary the required notice period.

scrutinize the conduct of both the debtor and the prospective buyer.[114] While there is no bright-line test for "good faith," bankruptcy courts generally look for signs of fraud, collusion, and unfair bidding procedures in connection with a proposed sale. If an "insider" or a fiduciary is involved, bankruptcy courts apply a heightened standard of scrutiny and focus on whether the insider or fiduciary received special treatment with respect to the proposed transaction.[115] Accordingly, if a Bankruptcy Code § 363 sale involves an insider or a fiduciary of the debtor, the parties to the transaction should disclose to the bankruptcy court the nature of the relationship between the parties, the circumstances surrounding the negotiation process, and the process by which the debtor ultimately determined the price and terms of the sale to be fair and reasonable.

2. Free and Clear Sales Requirements

As mentioned *supra*, unlike asset sales outside of bankruptcy, a primary benefit of conducting asset sales pursuant to Bankruptcy Code § 363 is that the assets are sold "free and clear" of existing liens and encumbrances.[116] While there are several limitations to a free and clear sale, and while the Bankruptcy Code's protections are not absolute, purchasers of a debtor's assets with bankruptcy court approval are afforded substantial protection from a debtor's liabilities.

Under Bankruptcy Code § 363(f), a trustee or debtor in possession may sell property free and clear of any interest of any entity other than the estate in such property, provided that at least one of five conditions is established:

114. *See* Wachtell, *supra* note 98 at 58; *In re Boston Generating, L.L.C.*, 440 B.R. at 330.
115. *See In re Mallory Co.*, 214 B.R. at 837–38.
116. 11 U.S.C. § 363(f) (2012).

1) applicable non-bankruptcy law permits the sale of such property free and clear of such interest;[117]

2) such entity 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;[118]

4) such interest is in bona fide dispute;[119] or

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117. Relevant non-bankruptcy law will typically be applicable state law. *See In re Curry*, 347 B.R. 596, 600 (6th Cir. B.A.P. 2006) ("When disputes over whether property is included in the estate arise, the bankruptcy court will determine the status and nature of the debtor's ownership or interest in the disputed property under applicable non-bankruptcy law, often state law, as of the time the bankruptcy petition was filed.") (citing *Butner v. United States*, 440 U.S. 48, 54-55 (1979)). There is currently a split in authority as to whether state foreclosure law may constitute "applicable non-bankruptcy law" under § 363(f)(1). *Compare In re* Jaussi, 488 B.R. 456, 458–59 (Bankr. D. Colo. 2013) (limiting scope of "applicable non-bankruptcy law" under § 363(f)(1) to legal options available to the debtor rather than to outside parties); Dishi & Sons v. Bay Condos L.L.C., 510 B.R. 696, 709–10 (S.D.N.Y. 2014) (limiting scope of provision to voluntary property transfers rather than New York foreclosure law); *with In re* Dulgerian, No. 06-10203 (JKF), 2008 WL 220523, at *4 (Bankr. E.D. Pa. Jan. 25, 2008) (citing to Pennsylvania foreclosure law to legitimate the free and clear sale of property to satisfy a mortgage while extinguishing an easement granted subject to the mortgage); *In re* Spanish Peaks Holdings II, L.L.C., No. 12-60041, 2015 WL 3767099, at *1 (D. Mont. June 16. 2015) (Montana foreclosure law constitutes "applicable nonbankruptcy law" for purposes of § 363(f)(1)); *In re* Wrangell Seafoods, Inc., No. K09-00012-DMD, 2009 WL 8478297, at *1 (Bankr. D. Alaska March 9, 2009) (Alaska foreclosure law constitutes "applicable nonbankruptcy law" for purposes of § 363(f)(1)); *In re* F.F. Station L.L.C., No. 6:07-BK-00575-ABB, 2007 WL 4898367, at *2 (Bankr. M.D. Fla. Dec. 3, 2007) (allowing sale of mortgaged property under § 363(f)(1) and (4) free and clear of leasehold interests).

118. Courts are split as to whether "value" as used here refers to the economic value or the face value of the liens. Most courts have concluded that the "aggregate value" refers to economic value. *In re Boston Generating, L.L.C.*, 440 B.R. at 332 ("As this Court held [previously], section 363(f)(3) should be interpreted to mean that 'the price must be equal to or greater than the aggregate *value* of the liens asserted against it, not their *amount*.'") (emphasis original, internal citations omitted); *In re* WK Lang Holdings, L.L.C., 2013 Bankr. LEXIS 5224, at *26-27 (Bankr. D. Kan. Dec. 11, 2013); *but see* Clear Channel Outdoor, Inc. v. Knupfer (*In re* PW, L.L.C.), 391 B.R. 25, 40-41 (9th Cir. B.A.P. 2008) ("[W]e join those courts . . . that hold that § 363(f)(3) does not authorize the sale free and clear of a lienholder's interest if the price of the estate property is equal to or less than the aggregate amount of all claims held by creditors who hold a lien or security interest in the property being sold.").

119. A "bona fide dispute" requires the interest to be in dispute on a fundamental level, and not simply contested on a peripheral or tangential matter. *See In re* Restaurant Assocs., L.L.C., No. 1:06CV53, 2007 WL 951849, at *9 (N.D. W. Va. Mar. 28, 2007).

5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[120]

The Bankruptcy Code does not define "interest" for purposes of Bankruptcy Code § 363(f). While some bankruptcy courts narrowly interpret "interest" to mean an *in rem* interest in property (e.g., a lien), most apply an expansive reading of the term and have found it to include liens, claims, and other encumbrances, except for "restrictions of record that run with the land."[121]

A sale free and clear under Bankruptcy Code § 363 requires that adequate protection be provided to parties with interests in the assets being sold.[122] Congress intended adequate protection to guard against loss in value of a secured creditor's interest in property of the bankruptcy estate during the bankruptcy case.[123] Adequate protection is based on the fundamental principle that secured creditors should not be deprived of the benefit of their bargain. The burden of proof as to adequate protection is on the debtor; however, the entity asserting an interest in the asset or assets to be sold has the burden of proof regarding its interest in such property.[124] In many free and clear sales, as a form of adequate protection, the interests will attach to the sale proceeds with the same validity, extent, and priority as such interests had when they encumbered the assets prior to the sale.[125]

Bankruptcy Code § 363 also requires notice of the sale to be sent to all creditors and parties who have liens or other interests in the assets being sold.[126] This notice requirement is expansive as it applies to the often numerous oil and gas counterparties, oil and gas lessors, secured and unsecured creditors, and regulatory authorities with interests in the assets.

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120. 11 U.S.C. § 363(f).

121. *In re* Trans World Airlines, Inc., 322 F.3d 283, 289 (3d Cir. 2003) (finding that the trend seems to be toward a more expansive reading of "interests in property" that "encompasses other obligations that may flow from ownership of the property"); Silverman v. Ankari (*In re* Oyster Bay Cove), 196 B.R. 251, 256 (E.D.N.Y. 1996) (finding that "the order to sell 'free and clear' has no [e]ffect on the dedication of the road and storm drain, which are easements that run *with* the land") (emphasis in original).

122. 11 U.S.C. § 363(e) (2012).

123. H.R. Rep. No. 95-595, 338–340 (1977); *In re* DeSardi, 340 B.R. 790, 796–97 (Bankr. S.D. Tex. 2006); *In re* Bovino, 496 B.R. 492, 502 (Bankr. N.D. Ill. 2013) (citing United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 370–71 (1998)).

124. 11 U.S.C. § 363(p).

125. *See*, *e.g.*, *In re* Sears Methodist Ret. Sys., No. 14-32821-11, 2015 Bankr. LEXIS 709, at *9–11 (Bankr. N.D. Tex. Mar. 5, 2015); *In re* Amidee Capital Group, Inc., No. 10-20041, 2010 Bankr. LEXIS 5702, at *10 (Bankr. S.D. Tex. Oct. 19, 2010).

126. FED. R. BANKR. P. 2002(a)(2).

a. Treatment of Easements and Covenants

Bankruptcy Code § 541 defines property of the estate to include, *inter alia*, "all legal or equitable interests of the debtor in property as of the commencement of the case."[127] Easements and covenants conveyed to third parties that run with the land (i.e., that are properly recorded in the relevant real property records) are not considered property of the debtor's estate under § 541 because the debtor does not hold a legal or equitable interest therein. As a result, a sale "free and clear of liens and other interests" generally does not impact restrictions of record that run with the land.[128]

As bankruptcy courts have noted, Bankruptcy Code § 363(f) is "not intended to sever easements and other non-monetary property interests that are created by substantive state law."[129] Accordingly, absent an easement owner's consent or a bona fide dispute regarding the easement, the Bankruptcy Code usually does not allow parties to utilize § 363(f) to sell property "free and clear" of a properly recorded easement or covenant.[130] However, the Fifth Circuit recently appeared to leave open the possibility that a § 363 sale could be free and clear of covenants running with the land if the bankruptcy court determined that one of the elements of Bankruptcy Code § 363(f) is met.[131] The real property records

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127. 11 U.S.C. § 541(a).
128. *In re Oyster Bay Cove, Ltd.*, 196 B.R. at 256.
129. *Id.* at 255.
130. *See id.* at 256.
131. Newco Energy v. Energytec, Inc. (*In re* Energytec, Inc.), 739 F.3d 215, 225–26 (5th Cir. 2013) (determining that a right to a "transportation fee" for use of a gas pipeline system constituted a covenant running with the land, and the bankruptcy court should give the initial answer as to "what constitutes a qualifying legal or equitable proceeding for purposes of Section 363(f)(5)" to determine whether the land may be sold free and clear of such interests pursuant to Bankruptcy Code § 363(f)(5)). These issues, raised in the context of motions to reject executory contracts, have recently become of keen interest and importance in pending upstream bankruptcy cases. On March 8, 2016, the Bankruptcy Court for the Southern District of New York in *In re* Sabine Oil and Gas Corp., *et al.*, Case No. 15-11835 [Docket No. 872], issued a ruling granting a motion by an upstream debtor to reject midstream gathering contracts, which the midstream counterparties argued contain covenants running with the land that could not be rejected under Bankruptcy Code § 365. Although the Court granted the rejection motion, in light of the Second Circuit's ruling in Orion Pictures Corp. v. Showtime Networks, Inc., 4 F.3d 1095 (2d Cir. 1993), which requires that a disputed legal issue between the parties be decided in an adversary proceeding and not in the context of a contested matter, it issued only a non-binding ruling that the dedications in the midstream contracts did not constitute covenants running with the land or equitable servitudes under Texas law because the requirements of privity and touching and concerning the land were not satisfied. The United States Bankruptcy Court for the District of Delaware in *In re*

in the county in which the land is located will typically disclose any recorded easements and covenants on the property that will continue to burden the target assets after a sale.

b. Successor Liability and Future Claims

In addition to the foregoing limitations, successor liability issues may arise in free and clear energy asset sales. In the bankruptcy context, purchasers are usually protected from liability to existing tort claimants, provided such claimants had notice of and an opportunity to participate in the bankruptcy case.[132] This policy encourages purchasers of energy assets to participate in bankruptcy sales, thereby maximizing value received by the estate. Moreover, this policy treats similarly situated creditors equally by prohibiting existing creditors from prosecuting claims against a debtor's successor.

However, unlike the treatment of existing tort claimants, bankruptcy courts continue to debate whether or not they have the jurisdiction or the power to protect purchasers of distressed assets from future claims (i.e., claims that arise post-petition as a result of the debtor's prepetition conduct).[133] In general, bankruptcy courts faced with the issue of successor liability typically look to whether the future claimants have "claims" within the meaning of the Bankruptcy Code, such that their claims would fall within the bankruptcy court's jurisdiction.[134]

Bankruptcy courts generally employ one of three tests to determine whether a future claimant has a prepetition claim against a debtor: (1) the conduct test; (2) the prepetition relationship test; and (3) the *Piper* test.

Quicksilver Resources, Inc. *et al.*, Case No. 15-10585, took a similar motion under advisement on March 4, 2016, though in that case, the rejection motion follows and relates to a court-approved sale of substantially all of the Debtors' assets free and clear of liens, claims, and encumbrances, which complicates the issue of how and if rejection impacts covenants running with the land in GPAs, which already were subjected to the free and clear sale of assets under Bankruptcy Code § 363. A decision in *Quicksilver* is expected this month.

132. *See* Am. Living Sys. v. Bonapfel *(In re* All Am. of Ashburn, Inc.), 56 B.R. 186, 190–91 (Bankr. N.D. Ga. 1986); *In re* White Motor Credit Corp., 75 B.R. 944, 950–51 (Bankr. N.D. Ohio 1987); *In re* Pan Am. Hosp. Corp., 364 B.R. 832, 838 (Bankr. S.D. Fla. 2007); *In* re Remember Enters., 425 B.R. 757, 764–65 (Bankr. M.D.N.C. 2010).

133. *See*, *e.g.*, Mooney Aircraft Corp. v. Foster *(In re* Mooney Aircraft, Inc.*)*, 730 F.2d 367, 375 (5th Cir. 1984); Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 163-64 (7th Cir. 1994) (finding that the bankruptcy court did not have jurisdiction to enjoin future tort claimants); *In re* Dura Auto. Sys., No. 06-11202, 2007 Bankr. LEXIS 2764, at *265–68 (Bankr. D. Del. Aug. 15, 2007).

134. *See In re* White Motor Credit Corp., 75 B.R. at 950–51; Morgan Olson L.L.C. v. Frederico *(In re* Grumman Olson Indus.*)*, 467 B.R. 694, 704 (S.D.N.Y. 2012); *In re* Dura Auto. Sys., No. 06-11202, 2007 Bankr. LEXIS 2764, at *265–68; *In re* Desa Holdings Corp., 353 B.R. 419, 426–27 (Bankr. D. Del. 2006).

Under the conduct test, a claim arises when the debtor's conduct giving rise to the claim occurred.[135] Under the prepetition relationship test, the claimant's relationship with the debtor must have existed prior to the filing of the bankruptcy petition.[136] The *Piper* test is a hybrid test combining both the conduct test and the prepetition relationship test to determine whether a tort victim holds a claim.[137]

3. Other 363 Sale Considerations

In addition to the foregoing § 363 sale considerations, other issues particular to in-court sales are worthy of note, including appeals and statutory mootness, bidder collusion, partitioning of co-owned property, and issues of interest to intellectual property licensees. These topics are addressed in the subparts that follow *infra*.

a. Appeals and Statutory Mootness

Bankruptcy Code § 363(m) provides that an authorized sale that is subsequently reversed or modified on appeal remains valid if the purchase was made in good faith and the sale was not stayed pending appeal.[138] Accordingly, the purchaser is generally protected from reversal of a sale,

135. *See* Grady v. A.H. Robins Co. (*In re* A.H. Robins Co.), 839 F.2d 198, 202–03 (4th Cir. 1988); Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1275 (5th Cir. 1994); *In re* Huffy Corp., 424 B.R. 295, 304 (Bankr. S.D. Ohio 2010); Morgan Olson, L.L.C.. v. Frederico (*In re* Grumman Olson Indus.), 445 B.R. 243, 251 (Bankr. S.D.N.Y. 2011) ("Under the conduct test, a right to payment arises when the conduct giving rise to the alleged liability occurred. In other words, all of the acts constituting the tort other than the manifestation of injury had occurred prior to the petition date.") (internal citations and quotations omitted).

136. *See In re* Piper Aircraft Corp., 162 B.R. 619, 622–24 (Bankr. S.D. Fla. 1994); *In re* Grumman Olson Indus., 445 B.R. at 251 n.8 ("Under the pre-petition relationship test, only individuals with 'some type of prepetition relationship with the Debtor' hold claims.") (internal citations omitted); *Lemelle*, 18 F.3d at 1276; *Huffy*, 424 B.R. at 304.

137. Epstein v. Official Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995) (adopting a two-part test—the "*Piper*" test—that combined the conduct and pre-petition relationship tests to determine whether a tort victim holds a "claim"); *see also In re* Grumman Olson Indus., 445 B.R. at 253.

138. 11 U.S.C. § 363(m) (2012). The purchaser's knowledge of the pendency of an appeal is irrelevant.

so long as the purchaser acted in good faith and the other party failed to obtain a stay.[139]

Since the Bankruptcy Code does not define "good faith" for the purposes of § 363(m), courts typically apply traditional equity principles to guide their findings as to good faith in sale orders.[140] Examples of

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139. *See, e.g.*, Licensing by Paolo v. Sinatra (*In re* Gucci), 105 F.3d 837, 839–40 (2d Cir. 1997) ("Though [Bankruptcy Code § 363(m)] in terms states only that an appellate court may not 'affect the validity' of a sale of property to a good faith purchaser pursuant to an unstayed authorization, and can even be read to imply that an appeal from an unstayed order may proceed for purposes other than affecting validity of the sale, courts have regularly ruled that the appeal is moot."); SBA v. XACT Telesolutions, Inc. (*In re* XACT Telesolutions, Inc.), 2006 U.S. Dist. LEXIS 621, at *16–18 (D. Md. Jan. 10, 2006) ("Once a bankruptcy sale has been consummated, [Bankruptcy Code] § 363(m) deprives courts of jurisdiction to review the sale except on the limited issue of whether the sale was made to a good faith purchaser."); Cargill, Inc. v. Charter Int'l Oil Co. (*In re* The Charter Co.), 829 F.2d 1054, 1056 (11th Cir. 1987); *but see In re PW, L.L.C.*, 391 B.R. at 35–37 ("Clear Channel") (narrowly construing Bankruptcy Code § 363(m) to apply only to the overall sale and not to the specific terms thereof). The Bankruptcy Appellate Panel's holding in *Clear Channel* remains controversial because it interprets Bankruptcy Code § 363(m) to permit reversal of the free and clear terms of a sale. The *Clear Channel* holding ignored prior Ninth Circuit authority applying Bankruptcy Code § 363(m) to a free and clear sale under Bankruptcy Code § 363(f) in *In re Robert L. Helms Const. & Dev. Co., Inc.*, 110 F.3d 1470, 1475 (9th Cir. 1997), and the *Clear Channel* decision has been heavily criticized by courts in the Ninth Circuit and in other jurisdictions. *See, e.g.*, Official Comm. Of Unsecured Creditors v. Anderson Senior Living Prop., L.L.C. (*In re* Nashville Living, L.L.C.), 407 B.R. 222, 229–32 (B.A.P. 6th Cir. 2009) (stating that "*Clear Channel* cited no case law for its conclusion and the overwhelming weight of authority disagrees with its holding that the [Bankruptcy Code] § 363(m) stay does not apply to the 'free and clear' aspect of a sale under [Bankruptcy Code] § 363(f)"); United States v. Asset Based Res. Group, L.L.C., 612 F.3d 1017, 1019 n.2 (8th Cir. 2010) ("This court has consistently applied this [§ 363(m) mootness] principle in the bankruptcy context. [Appellant], relying on [*Clear Channel*], contends that [Bankruptcy Code §] 363(m) moots only appeals challenging transfers of title, not appeals challenging other aspects of court-approved sales. This distinction is not persuasive.") (internal citations omitted); Ace Fire Underwriters Ins. Co v. Plant Insulation Co. (*In re* Plant Insulation Co.), 2012 U.S. Dist. LEXIS 189155, at *17–19 (N.D. Cal. Oct. 9, 2012) (rejecting *Clear Channel* and "adopting the more persuasive, latter line of authority" to find that "[b]ecause the designation is 'integral' to the sale authorized under [Bankruptcy Code] § 363(b), the doctrine of statutory mootness under [Bankruptcy Code] § 363(m) applies to this appeal, barring a showing by appellants that the purchase was not consummated in good faith"); *In re* Thorpe Insulation Co., 2011 U.S. Dist. LEXIS 38879, at *3–4 (C.D. Cal. Apr. 11, 2011) ("*Clear Channel* does support Appellants' position, but it has been widely criticized by courts and commentators and is generally unpersuasive.").

140. *See In re* Tempo Tech. Corp., 202 B.R. 363, 367 (D. Del. 1996) ("Neither the Bankruptcy Code nor the Bankruptcy Rules define 'good faith.' In construing this phrase, courts have therefore borrowed from traditional equitable principles, holding that the concept of 'good faith' speaks to the integrity of a party's conduct in the course of the bankruptcy sale proceedings.") (internal citations omitted).

conduct lacking good faith include fraud, collusion, and attempts to gain grossly unfair advantages over other bidders in the sale process.[141]

b. Collusion by Bidders Prohibited

Bankruptcy Code § 363(n) permits a trustee to: (1) avoid a sale if the price was controlled by an agreement among potential bidders, or (2) recover from a collusive party to the extent the value of the property sold exceeds the actual sale price.[142] A trustee may also recover any costs, attorneys' fees, or expenses incurred in avoiding a collusive sale or recovering funds from a collusive party.[143] Importantly, Bankruptcy Code § 363(n) also authorizes a bankruptcy court to assess punitive damages against a collusive party in favor of the estate if such party willfully engaged in collusive behavior.[144]

For purposes of § 363(n), a collusive agreement may be oral and need not take the form of an explicit written contract, but the agreement must be made with the intent to control the sale price, rather than merely affecting the price as an unintended consequence.[145] The mere existence of a joint bid or cooperation among bidders does not itself evidence bad faith or amount to collusive bidding under Bankruptcy Code § 363(n).[146] Bidders may choose to work together or split up assets in a joint bid in order to complete a large transaction. Courts have focused, in determining the good faith of bidders, on whether acts were disclosed to the bankruptcy court.[147]

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141. *Id.*
142. 11 U.S.C. § 363(n).
143. *Id.*
144. *Id.*
145. *See* Lone Star Indus. v. Compania Naviera Perez Companc, S.A.C.F.I.M.F.A. (*In re* New York Trap Rock Corp.), 42 F.3d 747, 752 (2d Cir. 1994) ("The influence on the sale price must be an intended objective of the agreement, and not merely an unintended consequence, for the agreement among potential bidders to come within the prohibition of § 363(n)."); *See also* Sunnyside Land, L.L.C. v. Sims (*In re* Sunnyside Timber, L.L.C.), 413 B.R. 352, 363 (Bankr. W.D. La. 2009).
146. *See*, *e.g.*, *In re* Edwards, 228 B.R. 552, 563–66 (Bankr. E.D. Pa. 1998).
147. *See, e.g.*, Kabro Assocs. v. Colony Hill Assocs. (*In re* Colony Hill Assocs.), 111 F.3d 269, 277 (2d Cir. 1997) ("Many courts ruling on challenges to a purchaser's good faith status have focused on whether the acts about which the appellant complained were disclosed to the bankruptcy court."); *In re* Sasson Jeans, Inc., 90 B.R. 608, 610 (S.D.N.Y. 1988) (explaining that the court was "hard pressed" to determine bad faith when a challenged relationship between bidder and debtor "was fully disclosed to the Bankruptcy Court").

c. Partitioning (Co-Ownership)

Energy assets often have multiple owners with subdivided or co-owned interests. In certain circumstances, pursuant to Bankruptcy Code § 363(h), a debtor may sell co-owned assets, including the co-owner's interests, without the co-owner's consent if the debtor accounts to the co-owner for its share of the proceeds.[148] Bankruptcy Code §§ 363(h) and 363(i) codify the right of the debtor or trustee, proceeding from the debtor's position as one of the joint tenants or tenants in common, to cause the liquidation of co-owned property when partition is impracticable and when the co-owner will not exercise its right of first purchase.[149] Importantly, Bankruptcy Code § 363(i) gives the co-owner a statutory right of first refusal in such a sale,[150] and Bankruptcy Rule 7001 requires an adversary proceeding to sell a co-owner's interests in assets.[151] An exception to this general rule precludes a debtor from selling co-owned assets used in the production, transmission, or distribution for sale of electric energy, natural gas, or synthetic gas for heat, light, or power.[152]

d. Licensees of Intellectual Property

Bankruptcy Code § 365(n) provides special statutory protection for licensees of rights to intellectual property,[153] allowing them to retain their rights under intellectual property agreements as those rights existed immediately preceding the filing of the bankruptcy case.[154] Thus, licensees maintain "squatter's rights" regardless of a debtor's decision to reject the executory intellectual property agreement and sell its intellectual property free and clear of the licensee's interest.[155]

148. 11 U.S.C. § 363(h) (2012).

149. *See* Official Comm. of Unsecured Creditors v. Anderson Senior Living Prop., L.L.C. (*In re* Nashville Senior Living, L.L.C.), 407 B.R. at 222, 227 (B.A.P. 6th Cir. 2009).

150. 11 U.S.C. § 363(i).

151. FED. R. BANKR. P. 7001(3).

152. 11 U.S.C. § 363(h)(4). There is limited case law interpreting this provision as a safeguard for co-owners to prevent the sale of property without their consent.

153. The Bankruptcy Code defines "intellectual property" to include, to the extent protected by applicable non-bankruptcy law: (i) trade secrets; (ii) inventions, processes, designs, or plants protected under Title 35; (iii) patent applications; (iv) plant varieties; (v) works of authorship under Title 17; and (vi) mask works protected under Chapter 9 of Title 17. 11 U.S.C. § 101(35)(A).

154. 11 U.S.C. § 365(n).

155. *See, e.g.*, TMC AeroSpace, Inc. v. Joseph (*In re* Ice Mgmt. Sys.), No. 14-1046, 2014 WL 6892739, at *2 (B.A.P. 9th Cir. Dec. 8, 2014) (holding that "a sale free and clear of [a licensee's] rights under § 363(f) was an impermissible impairment of its elected license rights under § 365(n)").

For example, in *In re Dynamic Tooling Systems, Inc.*, a Chapter 11 debtor sought to sell its assets, including intellectual property, free and clear of all liens, claims, and interests, pursuant to a creditor's proposed plan of reorganization.[156] A licensee of the debtor's intellectual property elected to continue to use the licensed intellectual property.[157] While the creditor proposing the plan assured that the "free and clear" language proposed in the sale order would not bar the licensee's right to use the intellectual property, the bankruptcy court was not satisfied.[158] The court applied the adequate protection requirement under Bankruptcy Code § 363(e)[159] as grounds for ordering that the sale be subject to the licensee's rights in the debtor's intellectual property.[160]

B. The 363 Sale Mechanics and Procedures

The complexities particular to the necessary mechanics and procedures applicable to § 363 sales include those related to the marketing process, stalking horse bids, break-up fees, bidding procedures, and the negotiation of asset purchase agreements, which include many highly negotiated provisions. The details of these § 363 sale aspects are discussed in this section.

1. The Marketing Process

As part of the initial marketing process, sellers often utilize independent financial advisors, such as investment banks or consulting firms, to assess the value of assets to be sold and to test the marketplace for potential buyers. The marketing process helps to determine a fair and reasonable sale price, and it attracts as many potential buyers as possible. Moreover, a transparent marketing process helps to ensure the integrity of the sale and maximize value for the debtor's estate.

As discussed *supra*, where a debtor has not effectively marketed the assets sought to be sold in a Bankruptcy Code § 363 sale, a bankruptcy court may consider such action to be evidence of a lack of good faith,[161]

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156. *In re* Dynamic Tooling Sys., Inc., 349 B.R. 847, 855 (Bankr. D. Kan. 2006).
157. *Id.*
158. *Id.*
159. The Bankruptcy Code provides that, upon a timely request from a party that has an interest in property proposed to be used, sold, or leased, the court "shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e).
160. *In re* Dynamic Tooling Sys., 349 B.R. at 856. Issues regarding assumption and assignment of certain intellectual property rights are discussed *infra*.
161. *See*, *e.g.*, *In re* Bidermann Indus. U.S.A., Inc., 203 B.R. 547, 549–53 (Bankr. S.D.N.Y. 1997); *In re* Boston Generating, L.L.C., 440 B.R. at 323–30.

particularly when the buyer is an insider or has inside connections to the potential sale. In contrast, when a transparent and robust marketing process has occurred, a bankruptcy court is more likely to find that a sale was fair.[162]

2. Stalking Horse and Break-Up Fees

"Stalking horse" is a term used to describe the initial prospective purchaser of a debtor's assets. It may be that a stalking horse emerges and engages in negotiations with the debtor before the debtor files for bankruptcy, or a stalking horse may be found post-petition during the marketing process. To invoke the powers and protections of the Bankruptcy Code, particularly those set forth in Bankruptcy Code § 363, the stalking horse may insist that the asset sale transpire in the bankruptcy forum.

The stalking horse typically spends considerable time performing due diligence on distressed assets and negotiating with the debtor to obtain satisfactory purchase terms. A stalking horse enjoys the distinct advantage of having access to diligence information early in the process, which enables it to make an initial bid on the assets. Given the time and energy expended by the stalking horse in preliminary negotiations for the debtor's assets and the threat of another buyer overbidding it at auction, the stalking horse may require a break-up fee in the event that it is not chosen as the successful bidder at auction. By reimbursing the stalking horse for transaction costs incurred in performing due diligence and in negotiating the terms of the asset purchase agreement and the bidding procedures,[163] break-up fees tend to: (1) encourage the stalking horse to make a binding offer; (2) encourage competitive bidding by evidencing the stalking horse's view of the value of the assets; (3) set a floor early in the sale process indicating the "worst case" outcome of the sale process; and (4) create momentum toward consummating a sale.[164] Depending on the size of the transaction, a break-up fee can generally range from three to five percent of the gross sale price.

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162. *In re Boston Generating, L.L.C.*, 440 B.R. at 323–30.

163. *See In re* APP Plus, Inc., 223 B.R. 870, 874 (Bankr. E.D.N.Y. 1998); U.S. Trustee v. Bethlehem Steel Corp. *(In re Bethlehem Steel Corp.)*, No. 02 Civ. 2854 (MBM), 2003 U.S. Dist. LEXIS 12909, at *27–28 n.11 (S.D.N.Y. July 23, 2003); Canatxx Gas Storage Ltd. v. Silverhawk Capital Partners, L.L.C., No. H-06-1330, 2008 U.S. Dist. LEXIS 37803, at *17–19 (S.D. Tex. May 8, 2008).

164. *See In re APP Plus, Inc.*, 223 B.R. at 874.

The permissibility of break-up fees falls within the discretion of the bankruptcy court.[165] Some bankruptcy courts apply the business judgment rule in upholding break-up fees, requiring the debtor's inclusion of a break-up fee in an asset purchase agreement to be based upon an informed, good faith business decision.[166] However, if a buyer is an insider of the debtor, a bankruptcy court may apply higher scrutiny to a break-up fee.[167] Bankruptcy courts focus on ensuring that Bankruptcy Code § 363 sales are in the best interest of the estate.[168] Bankruptcy courts that disfavor break-up fees generally view them as an unnecessary expense for the estate that may chill bidding,[169] and some argue that increasing the availability of information and standardizing bidding procedures would be a better approach.[170]

Among the relevant factors that courts consider when determining whether to approve a break-up fee are whether:

1) the fee requested is aligned with the policy of maximizing the value of the debtor's estate;

2) the underlying negotiated agreement constitutes an arm's-length transaction;

3) any of the debtor's secured or unsecured creditors have objected to the break-up fee;

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165. *See, e.g.*, *In re* Reliant Energy Channelview LP, 594 F.3d 200, 210 (3d Cir. 2010) (holding that "[t]he Bankruptcy Court did not abuse its discretion when it concluded that an award of a break-up fee was not necessary to preserve the value of the estate").

166. *See, e.g.*, Cottle v. Storer Commc'n, Inc., 849 F.2d 570, 579 (11th Cir. 1988) (holding a $29 million termination fee to be protected by the business judgment rule where the fee was not shown to be unreasonable in relation to a $2.5 billion transaction); *In re* ASARCO L.L.C., 441 B.R. 813, 825–33 (S.D. Tex. 2010).

167. *See, e.g.*, *In re* Bidermann Indus. U.S.A., Inc., 203 B.R. 547, 551 (Bankr. S.D.N.Y. 1997) (explaining that "sales to [insiders] in chapter 11 cases are not *per se* prohibited, but [they] are necessarily subjected to heightened scrutiny because they are rife with the possibility of abuse") (citing *In re* Wingspread Corp., 92 B.R. 87 (Bankr. S.D.N.Y. 1988)) (internal quotations omitted).

168. *See, e.g.*, *In re* Am. W. Airlines, Inc., 166 B.R. 908, 912 (Bankr. D. Ariz. 1994).

169. *See, e.g.*, *In re* S.N.A. Nut Co., 186 B.R. 98, 101–06 (Bankr. N.D. Ill. 1995) (finding that a break-up fee was not in the best interests of the estate); *In re Am. W. Airlines, Inc.*, 166 B.R. at 910–14 (stating that the appropriate standard is not the business judgment rule, but whether the break-up fee is in the best interests of the debtor, creditors, and equity holders); *In re* Beth Isr. Hosp. Ass'n, No. 06-16186 (NLW), 2007 Bankr. LEXIS 2386, at *31–42 (Bankr. D.N.J. July 12, 2007).

170. *See In re S.N.A. Nut Co.*, 186 B.R. at 103–04.

4) the break-up fee comprises a fair and reasonable portion of the proposed purchase price;

5) the size of the break-up fee is so significant that it imposes a chilling effect on competing bidders;

6) available safeguards exist that are beneficial to the debtor's estate; and

7) the break-up fee imposes a substantial adverse impact on unsecured creditors.[171]

3. Bidding Procedures and Key Sale Process Steps and Deadlines

Both bankruptcy courts and debtors generally favor asset sales by auction over private sales because the auction process, although not without its costs, generally yields the greatest value for a debtor's assets, and it usually produces a fair arm's-length transaction. Before an auction takes place, a debtor typically files and seeks court approval of proposed bidding and auction procedures. If the bankruptcy court approves the bidding procedures, the parties typically will serve a transaction notice on parties in interest and establish a timeline for certain events leading up to the auction.

Bidding procedures are highly negotiated and are often crafted based on the circumstances of each case. Examples of common terms in bidding procedures include:

1) a deadline by which parties must notify the debtor of their interest in the debtor's assets;

2) a deadline by which a draft of the form of asset purchase agreement is distributed to potential qualified bidders;

3) a deadline for potential qualified bidders to submit

   a) an executed confidentiality agreement acceptable to the debtor, and

   b) financial statements acceptable to the debtor, demonstrating the potential qualified bidder's financial capability and legal authority to close the proposed transaction in a timely manner;

4) a deadline for qualified bidders to submit competing bids;

171. *See In re* Hupp Indus., Inc., 140 B.R. 191, 194 (Bankr. N.D. Ohio 1992); *see also In re* Nashville Senior Living, 2008 Bankr. LEXIS 3197, at *6–10.

5) a requirement that competing bids contain substantially similar terms and conditions as those set forth in the stalking horse's proposed asset purchase agreement;

6) a requirement that all bids be made in certain incremental amounts;

7) a requirement that qualified bidders pay a minimum deposit;

8) provisions regarding reasonable overbid amounts;[172]

9) a date for the auction to take place;

10) terms that define or limit credit bidding;

11) provisions allowing the debtor to determine, in its discretion, the highest and best offer; and

12) a date for the hearing on the asset sale post-auction.[173]

Credit bidding is a term used to describe a creditor's authority to bid on assets secured by such creditor's lien. Credit bidding is authorized under Bankruptcy Code § 363(k); absent an order for "cause" otherwise, that provision allows a secured creditor to bid at auction and, if successful, offset its claim against the asset purchase price.[174] A secured creditor may credit bid in an amount up to its entire claim against the debtor, not just the secured

172. *See In re* Hupp Indus., Inc., 140 B.R. at 193 (rejecting a $300,000 overbid amount as "arbitrary and unreasonably high"); U.S. Trustee v. Bethlehem Steel Corp. (*In re* Bethlehem Steel Corp.), No. 02 Civ. 2853 (MBM), 2003 U.S. Dist. LEXIS 12909, at *27–28 n.11 (S.D.N.Y. July 23, 2003).

173. A bankruptcy court may refuse to authorize a sale under Bankruptcy Code § 363 after an auction for a number of reasons, including submission by a prospective purchaser of a higher bid for the debtor's assets after the auction is completed. *See, e.g.*, Corporate Assets, Inc. v. Paloian, 368 F.3d 761, 762–63 (7th Cir. 2004) (upholding bankruptcy court's decision to authorize a second auction when higher bid was submitted after the close of the first auction). In the event that a prospective buyer submits such a post-auction bid, the bankruptcy court may reopen the auction in accordance with the Bankruptcy Code's fundamental policy of maximizing the value of a debtor's estate for the benefit of the debtor's creditors. *Id.* at 772–73 ("[T]he prospect of additional renumeration for the estate and its creditors outweighed concerns about the finality and regularity of the sale proceeding."); *see also* Hytken v. Williams, No. H-06-2169, 2007 U.S. Dist. LEXIS 27671, at *17–18 (S.D. Tex. Mar. 30, 2007).

174. 11 U.S.C. § 363(k) (2012).

portion of its claim.[175] Accordingly, a secured creditor may credit bid and purchase the property encumbered by its lien by prevailing at auction, but it may need to pay any amount of the purchase price that exceeds the total value of its claim or is owed to senior lienholders.[176] However, parties may seek agreements to limit credit bidding in certain circumstances, either by setting incremental thresholds for credit bidding or by prohibiting a lienholder from credit bidding against the stalking horse.

4. Asset Purchase Agreements

An asset purchase agreement (APA)—sometimes alternatively called a purchase and sale agreement (PSA)—is a highly complex document, heavily negotiated by the parties thereto. This subsection delves into provisions often found in an APA, including provisions allowing for the assignment of executory contracts and unexpired leases as well as provisions regarding rights of first refusal, consent rights, and preferences.

a. Typical Provisions

An APA is a contract between two or more parties that governs the terms and conditions regarding a future sale of certain specified assets. Bidding procedures generally require a qualified bidder to submit an APA to evidence its bid. Depending on the terms of the bidding procedures, qualified bidders may be required to submit APAs on substantially similar terms as the stalking horse's APA.

Among other provisions, APAs contain defined contract terms to be used in the APA, purchase and sale pricing and business terms, conditions to closing, representations and warranties, covenants, and termination provisions. APAs in energy transactions may also contain additional negotiated provisions, including those relating to:

175. *See In re* SunCruz Casinos, L.L.C., 298 B.R. 833, 839 (Bankr. S.D. Fla. 2003) ("[T]he plain language of [Bankruptcy Code § 363(k)] makes clear that the secured creditor may credit bid its *entire claim*, including any unsecured deficiency portion thereof") (emphasis original); *In re* Midway Invs., Ltd., 187 B.R. 382, 391 (Bankr. S.D. Fla. 1995); *but see In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 61 (Bankr. D. Del. 2014) (holding that "the holder of a lien the validity of which has not been determined . . . may not [credit] bid its lien") (citing *In re* Daufuskie Island Props., L.L.C., 441 B.R. 60 (Bankr. D.S.C. 2010)).

176. *See* COLLIER ON BANKRUPTCY ¶ 363.09[3] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

1) purchase price adjustments;

2) pre-closing covenants, such as maintenance of oil and gas assets, authorizations for expenditures (AFEs), and well elections;

3) property access;

4) indemnity by the potential buyer for liabilities caused by the buyer in the course of performing its due diligence;

5) limited title representations, defect mechanics, and hold-backs;

6) environmental diligence terms, defect mechanics, and hold-backs;

7) preferential rights to purchase, rights of first refusal, and consent rights;

8) anti-survival clauses;

9) termination rights;

10) default remedies;

11) closing conditions;

12) post-closing covenants; and

13) dispute mechanics.[177]

Until a debtor receives the bankruptcy court's approval, it cannot be bound by an APA executed outside of the ordinary course of business, even if it is negotiated in connection with a Bankruptcy Code § 363 sale.[178] Once the debtor obtains a court order approving the sale, the sale may close. Unlike a debtor, absent an express provision in the APA to the contrary, a purchaser may be bound by the terms of an APA upon

177. *See* Wallander, *supra* note 1 at 49-50.

178. 11 U.S.C. § 363(b)(1) (2012); *In re* Asia Global Crossing, Ltd., 326 B.R. 240, 256 (Bankr. S.D.N.Y. 2005) (holding that a debtor is not bound by a sale contract until it receives court approval).

execution, even if bankruptcy court approval has not yet been obtained.[179] As a result, it is not uncommon for purchasers to require that the effectiveness of an APA be contingent upon a satisfactory order by the bankruptcy court authorizing the sale.

b. Assignment of Executory Contracts and Unexpired Leases

Purchasers of oil and gas assets frequently seek to include in APAs a provision that requires certain executory contracts and unexpired leases to be assumed and assigned to them as part of a sale. An "executory contract" is commonly defined as "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 the performance of the other."[180] "Unexpired leases" are leases of personal or real property that have not been terminated prior to the petition date with the specific interests defined by applicable state law.[181] Before an executory contract or unexpired lease may be assigned, a debtor must first assume it. That assumption triggers the requirements in Bankruptcy Code § 365(b) that: (1) the debtor cures any defaults under the executory contract or unexpired lease to be assumed, and (2) the assignee provides adequate assurance of its future performance under such contract or lease.[182] APAs frequently allocate payment of cure costs to the debtor or the purchaser. Notably, the Bankruptcy Code permits the assignment of an executory contract and unexpired lease, notwithstanding contractual "anti-assignment" provisions that might otherwise limit assignment.[183]

Intellectual property licenses are unique executory contracts. Accordingly, assignment of intellectual property licenses presents obstacles for buyers looking to purchase intellectual property from a distressed energy company. While Bankruptcy Code § 365(f)(1) renders anti-assignment provisions generally unenforceable, Bankruptcy Code

179. The purchaser's execution of an APA constitutes a binding offer that may be accepted by the debtor with court approval. *See* RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981) ("An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.").

180. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); *see also* Phoenix Exp., Inc. v. Yaquinto (*In re* Murexco Petro, Inc.), 15 F.3d 60, 62–63 (5th Cir. 1994); *but see* Chattanooga Mem'l Park v. Still *(In re* Jolly*)*, 574 F.2d 349, 351 (6th Cir. 1978) ("The key . . . is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish. If those objectives have already been accomplished, or if they can't be accomplished through rejection, then the contract is not executory . . . .").

181. *See* Brattleboro Hous. Auth. v. Stoltz (*In re* Stoltz), 197 F.3d 625, 629 (2d Cir. 1999).

182. 11 U.S.C. §§ 365(f)(2)(A), 365(b).

183. 11 U.S.C. § 365(f)(1).

§ 365(c)(1) provides that a debtor may not assume or assign any executory contract or unexpired lease, if "applicable law" excuses another party to such contract or lease "from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession."[184] Bankruptcy Code § 365(c)(1) has been held to prohibit the assignment of certain executory contracts involving intellectual property that contain anti-assignment provisions because such assignments are prohibited under federal copyright, trademark, and patent laws.[185]

Indeed, a majority of courts forbid the assignment of contracts containing anti-assignment language by a debtor where such assignment is prohibited by intellectual property law.[186] Courts have found *non-exclusive* licenses to intellectual property to be non-assignable without the consent of the licensor or another party to the license.[187] However, courts remain split as to whether an *exclusive* license to intellectual property is assignable under Bankruptcy Code § 365(c)(1) without consent of the licensor or another party to the contract.[188]

c. Rights of First Refusal, Consent Rights, and Preferences

Many energy contracts, including joint operating agreements (JOAs), commonly include rights of first refusal or other preferential rights that may be triggered by a proposed asset sale. The law lacks clarity as to

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184. 11 U.S.C. § 365(c)(1).

185. *See*, *e.g.*, *In re* Golden Books Family Entm't, Inc., 269 B.R. 300, 310 (Bankr. D. Del. 2001).

186. *See* RCI Tech. Corp. v. Sunterra Corp. (*In re* Sunterra Corp.), 361 F.3d 257, 262 (4th Cir. 2004); Perlman v. Catapult Entm't (*In re* Catapult Entm't), 165 F.3d 747, 751–53 (9th Cir. 1999).

187. N.C.P. Mktg. Grp. v. Blanks (*In re* N.C.P. Mktg. Grp., Inc.), 337 B.R. 230, 236–37 (D. Nev. 2005) (finding that federal common law, and thus Bankruptcy Code § 365(c)(1), prohibits assignment of nonexclusive trademark licenses without consent of the licensor), *aff'd*, 279 F. App'x 561 (9th Cir. 2008); *In re* Patient Educ. Media, Inc., 210 B.R. 237, 240–43 (Bankr. S.D.N.Y. 1997) ("Accordingly, the nonexclusive license is personal to the transferee, and the licensee cannot assign it to a third party without the consent of the copyright owner."); Isbell v. DM Records, Inc., 2013 U.S. Dist. LEXIS 189526, at *15 (E.D. Tex. July 16, 2013) ("[A] non-exclusive license to exploit a musical composition is not necessarily transferred when the rights to a master recording are purchased from a bankruptcy trustee. A copyright license cannot be transferred by the licensee without authorization of the licensor.").

188. *Compare* Gardner v. Nike, Inc., 279 F.3d 774, 777–81 (9th Cir. 2002) (holding that federal law bars assignment of exclusive copyright licenses "without the consent of the original licensor."), *with In re* Golden Books Family Entm't, Inc., 269 B.R. at 314–19 (holding that federal law permits assignment of exclusive copyright licenses regardless of licensor or counterparty consent because, "under applicable copyright law, exclusive licenses convey an ownership interest to the licensee that allows that licensee to freely transfer its rights.").

whether a debtor is bound by preferential rights in an executory contract or unexpired lease.[189] It is also unclear whether rights of first refusal or preferential rights to purchase can be considered executory contracts in and of themselves, such that a debtor may reject those rights if doing so would benefit the estate.[190] In energy bankruptcies, a sale might be impacted by a third party's preferential rights that, outside of bankruptcy, would be enforceable to substitute a third party as a purchaser.[191]

Some courts have compared preferential rights to options to purchase.[192] Most courts consider options to be executory until such an option is exercised.[193] Moreover, if an option holder must tender further consideration or take additional steps beyond merely signing a document or providing notice, courts are more likely to view the option as executory.[194] Accordingly, the preferential rights may be unenforceable if the agreement containing the preferential right is rejected.

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189. 11 U.S.C. § 365(f)(1) (2012).

190. *See In re* Riodizio, Inc., 204 B.R. 417, 422–24 (Bankr. S.D.N.Y. 1997) ("The case law confirms that executoriness [of option contracts] lies in the eyes of the beholder."); Unsecured Creditors' Comm. v. Southmark Corp. (*In re* Robert L. Helms Constr. & Dev. Co.), 139 F.3d 702, 705–06 (9th Cir. 1998) ("A better approach . . . is to ask whether the option requires further performance from each party at the time the petition is filed" and found that, typically, the option would not be executory because the "optionee need not exercise the option – if he does nothing, the option lapses without breach.").

191. Such rights may be enforceable, assuming the rights are valid under state law and do not constitute an unenforceable absolute restriction on alienation. *See generally* Wildenstein & Co. v. Wallis, 595 N.E.2d 828, 828 (N.Y. App. 1992).

192. ConocoPhillips Co. v. Dahlberg, No. CIV.A. C-10-285, 2011 WL 710604, at *1 n.2 (S.D. Tex. Feb. 22, 2011) ("A 'preferential right, also known as a right of first refusal or preemptive right, is a right granted to a party giving him or her the first opportunity to purchase property if the owner decides to sell it. . . . [W]hen the property owner gives notice of his intent to sell, the preferential right matures . . . into an enforceable option.'") (quoting FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., 301 S.W.3d 787, 793 (Tex. App.—Fort Worth 2009, *pet. denied*)); *but see In re Robert L. Helms Constr. & Dev. Co., Inc.*, 139 F.3d at 706 ("Performance due only if the optionee chooses at his discretion to exercise the option doesn't count [for executory contract analysis] unless he has chosen to exercise it.").

193. *In re Riodizio, Inc.*, 204 B.R. at 423 ("Most courts . . . consider an option contract to be executory although they reach their conclusions through different routes."); *In re* Kellstrom Indus., 286 B.R. 833, 834–835 (Bankr. D. Del. 2002).

194. *In re* Abitibibowater, Inc., 418 B.R. 815, 830–31 (Bankr. D. Del. 2009) (noting that "[n]umerous other courts have determined that contingent option agreements are executory when material obligations will arise on each side if the option is exercised.").

Depending on the jurisdiction and applicable state law, the recording of a contract containing a preferential right to purchase or right of first refusal may make such right a covenant running with the land, thereby precluding a debtor's ability to reject it.[195] However, some courts, including the Fifth Circuit, have held that the recordation of an option, even where it concerns real property, will not convert the option into a real property interest that is insulated from rejection.[196]

C. Plan Sales

Sale transactions may also be effectuated pursuant to a plan of reorganization or liquidation. While energy asset sales pursuant to Bankruptcy Code § 363 can be advantageous to parties because they avoid the expense and delay inherent in the plan process, a sale under a Chapter 11 plan is more flexible, offers greater possibilities with respect to the sale, and may offer more benefits to the parties in the long run. For example, a plan may include compromises of claims and issuance of debt or equity securities, along with providing different consideration to different classes of claimants and interest holders.[197] Additionally, a sale pursuant to a plan of reorganization may be less likely to trigger preferential rights to purchase or rights of first refusal if structured as a merger transaction or an equity sale, the "synthetic plan sale" discussed further *infra*.[198]

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195. *See*, *e.g.*, *In re* Plascencia, 354 B.R. 774, 780 (Bankr. E.D. Va. 2006) ("Virginia . . . has changed the traditional rule, so that an option is in the 'nature of an interest in real estate which may be recorded and by that recordation protect the optionee's interest in the real estate.'") (quoting Springfield Eng'g Corp. v. Three Score Dev. Corp., 26 Va. Cir. 186, 191 (1992)).

196. Rivercity v. Herpel (*In re* Jackson Brewing Co.), 567 F.2d 618, 623–24 (5th Cir. 1978) (finding that a lower court had the authority to allow rejection of a recorded option); *see also In re* A.J. Lane & Co., 107 B.R. 435, 438 (Bankr. D. Mass. 1989) (noting that the option "is only a contract right—the right to purchase—whose remedy is normally specific performance [and t]hat the world is given notice of this right though its appearance in a recorded deed prevents any other buyer from claiming the equities of an innocent third party, but that is all").

197. *See*, *e.g.*, *In re* Tropicana Entm't, L.L.C., 2009 Bankr. LEXIS 5455, at *36–37 (Bankr. D. Del. May 5, 2009) (discussing resolution and compromise of disputed claims and interests); *In re* Simon, 2008 Bankr. LEXIS 2787, at *6–7 (Bankr. E.D. Va. July 29, 2008) (finding that, while Bankruptcy Code § 1122(a) requires that all claims in a class be substantially similar, it does not require that all substantially similar claims be placed within the same class, and "[i]f a plan proponent can articulate legitimate differences among otherwise substantially similar claims and if separate classification is in the best interest of creditors and will foster reorganization, then separate classification may be proper."); COLLIER ON BANKRUPTCY ¶ 1122.03[1][a].

198. However, parties should review the applicable contracts and leases to determine the triggers of any preferential rights to purchase, consent rights, or rights of first refusal.

Moreover, the Bankruptcy Code § 1145 securities registration exemption provides more flexibility to use securities as part of the consideration for the sale, although that exemption is not available as part of a sale outside of a plan under Bankruptcy Code § 363.[199] The securities registration exemption permits the exchange of the securities of a debtor (or a successor to the debtor) principally for claims against the debtor.[200] A third party buyer who does not have claims against the debtor may also rely on any applicable non-bankruptcy securities exemption, such as a private placement, to purchase securities from the debtor.[201]

Furthermore, a plan sale must meet the voting and plan confirmation requirements of the Bankruptcy Code.[202] Thus, creditors will have the benefits of disclosure and the plan voting and confirmation processes—benefits that do not apply to asset sales under Bankruptcy Code § 363. These plan confirmation requirements protect creditors and also provide greater flexibility and powers to debtors through the plan sale process.

Plan sales are intended to be final, and courts, utilizing the doctrine of "equitable mootness," are generally reluctant to "unscramble the eggs" in the event a party seeks to appeal the confirmation of a plan.[203] Developed by appellate courts, the equitable mootness doctrine supports the dismissal of appeals from final bankruptcy court orders under certain circumstances.[204] The doctrine emerged in order to constrain appeals and potential reversals of sales or plans to favor finality in the bankruptcy process.[205] In *Pacific Lumber*, the Fifth Circuit found that equitable mootness is "firmly rooted in Fifth Circuit jurisprudence" and that the court's job is to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek

199. 11 U.S.C. §§ 1123(a)(5)(J), 1145, 1123(a)(5)(C) (2012).
200. 11 U.S.C. § 1145(a)(1)–(2).
201. 11 U.S.C. § 1126 (setting forth reorganization voting requirements); 11 U.S.C. § 1129(a) (outlining reorganization confirmation requirements).
202. 11 U.S.C. § 1129(a).
203. *See In re* Continental Airlines, 91 F.3d 553, 560–66 (3d Cir. 1996).
204. Bank of New York Trust Co., NA v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 240 (5th Cir. 2009) ("This court accordingly considers '(1) whether a stay was obtained, (2) whether the plan has been 'substantially consummated,' and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.'") (quoting Manges v. Seattle-First Nat'l Bank (*In re* Manges), 29 F.3d 1034, 1039 (5th Cir. 1994)); *see also In re* Continental Airlines, 91 F.3d at 560 ("Factors that have been considered by courts in determining whether it would be equitable or prudential to reach the merits of a bankruptcy appeal include (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.") (citing *In re* Manges, 29 F.3d at 1039; *In re* Public Serv. Co., 963 F.2d 469, 471-72 (1st Cir. 1992)).
205. *In re* Pac. Lumber Co., 584 F.3d at 240.

review of a bankruptcy order adversely affecting him."[206] Despite some criticism,[207] the doctrine of equitable mootness remains an important consideration in the plan sale process.

As discussed *infra*, parties seeking to consummate an energy sale by a plan of reorganization may select one of three primary options: (1) an asset sale; (2) a merger; or (3) a stock, or synthetic plan, sale. If parties are able to reach an agreement prior to the petition date, pre-packaged and pre-negotiated plans may be used to effectuate such sale structures.

1. Asset Sales and Mergers

Asset sales under plans of reorganization are similar to Bankruptcy Code § 363 sales in that they both enable a bankruptcy court to approve a transaction allowing a debtor to effectively sell its assets free and clear of liens, claims, and other encumbrances.

The Bankruptcy Code requires a plan of reorganization to "provide adequate means for the plan's implementation."[208] "Adequate means" includes the "transfer of all or any part of the property of the estate to one or more entities," the "merger or consolidation of the debtor with one or more persons," or the "sale of all or any part of the property of the estate."[209] Bankruptcy Code § 1123(a)(5)(C) permits the merger or consolidation of the debtor with "one or more persons" as part of the plan.[210] A "person" is defined to include a partnership or a corporation.[211] Accordingly, a debtor corporation may be merged with one or more other corporations under a plan of reorganization. Such mergers are expressly authorized under the Bankruptcy Code, rendering any other approval required by non-bankruptcy law unnecessary.

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206. *Id.* (quoting *In re* Manges, 29 F.3d. at 1039).

207. *In re* Continental Airlines, 91 F.3d at 569 (Alito, J., dissenting) ("Thus, as this case well illustrates, the doctrine of 'equitable mootness' is not really about 'mootness' at all in either the Article III or non-Article III sense. As the Seventh Circuit stated in a passage that the majority quotes with approval, 'there is a big difference between inability to alter the outcome (real mootness) and unwillingness to alter the outcome ('equitable mootness'). Using one word for two different concepts breeds confusion.'") (internal citations omitted); *see also In re* UNR Indus., Inc., 20 F.3d 766, 769 (7th Cir. 1994) (stating that "equitable mootness" is a misnomer and banished from the local lexicon in order to consider instead "whether it is prudent to upset the plan of reorganization at this late date").

208. 11 U.S.C. § 1123(a)(5) (2012).

209. 11 U.S.C. §§ 1123(a)(5)(B), (C) & (D).

210. 11 U.S.C. § 1123(a)(5)(C).

211. 11 U.S.C. § 101(41).

2. Synthetic Plan Sales

A plan of reorganization may also provide for a sale of equity interests in the reorganized debtor, often called a "synthetic plan sale." A synthetic plan sale process may be proposed as a mechanism for vesting properties of the bankruptcy estate free and clear of liens, claims, and encumbrances in a buyer. In a synthetic plan sale, equity interests in the reorganized debtor are issued to the purchaser, and any assets, liabilities, and claims not purchased are transferred to a liquidating trust.[212] A synthetic plan sale can often be structured in such a manner so as to avoid triggering preferential rights to purchase or rights of first refusal arising from actual asset transfers or contract assignments. Further protections are set forth in the plan's discharge and injunction provisions, which prohibit creditors from pursuing pre-confirmation claims against the buyer or the reorganized debtor owned by the buyer.[213]

3. Pre-Packaged Plans

A pre-packaged plan of reorganization offers an efficient method for effectuating a transfer under a plan. Unlike a conventional Chapter 11 plan that is negotiated post-bankruptcy, a "pre-packaged plan," or "prepack," is both negotiated and voted on before a debtor files for bankruptcy. Pre-packaged plans are commonly used when a sale transaction can be negotiated pre-bankruptcy; however, the parties to the sale must still invoke the powers of the bankruptcy process in order to bind non-consenting parties to the terms of the transaction.

Bankruptcy Code § 1121 allows a debtor to file a plan of reorganization simultaneously with its bankruptcy petition and seek confirmation of the plan based on the requisite number of votes cast pre-petition.[214] This expedited mechanism mitigates certain negative externalities which flow from a traditional Chapter 11 reorganization, including litigation costs, business disruption, negative publicity, turnover, and delays.[215] Furthermore, by enabling the case to proceed straight to confirmation, pre-packaged plans also minimize judicial involvement in the debtor's business affairs and operations.

While the benefits are plentiful, prepackaged plans come with a cost, in that general trade creditors must often be paid in full under the plan to be unimpaired. Unimpaired creditors are deemed to vote to accept a plan; their votes need not be solicited.[216] This unimpairment of trade creditors is important because, *inter alia*, soliciting votes from hundreds—if not

212. 11 U.S.C. §§ 1123(a)(5)(B), (a)(5)(D), & (b)(3)(B).
213. 11 U.S.C. § 1141.
214. 11 U.S.C. § 1121.
215. *See* Wachtell, *supra* note 98, at 41–42.
216. 11 U.S.C. §§ 1126(f), 1129(a)(8)(B).

thousands—of trade creditors outside of bankruptcy can present an extremely difficult task. Accordingly, by paying the general trade creditors the full value of their claims, a prospective debtor seeking to confirm a prepackaged plan need not obtain the trade creditors' consent, thereby increasing the chances of plan confirmation.

To obtain confirmation of a pre-packaged plan, a debtor must adhere to the procedural requirements set forth in the Bankruptcy Code, or else risk the bankruptcy court refusing to confirm the prepackaged plan. Denial of confirmation may occur for a number of reasons, including a finding by the bankruptcy court that the solicitation process was deficient.[217] Bankruptcy Code § 1126(b) pertinently provides that: (1) prepackaged Chapter 11 plan votes must have complied with any applicable non-bankruptcy law, rule, or regulation governing the adequacy of disclosure of vote solicitation; or (2) if there is no such law, rule, or regulation, votes on a pre-packaged Chapter 11 plan must have been solicited after disclosure of "adequate information," as defined in the Bankruptcy Code.[218] The Federal Rules of Bankruptcy Procedure also require timely transmission of the plan and other solicitation materials "to substantially all creditors and equity holders of the same class."[219]

If the pre-packaged plan provides for the offering of new securities, parties must also determine whether the offering of such new securities is exempt from the Securities Act registration requirements. Bankruptcy Code § 1145(a) provides a safe harbor for the issuance of new securities under a conventional plan of reorganization and exempts from registration "the offer or sale under a plan of a security of the debtor."[220] Whether this safe harbor exists with respect to pre-packaged plans, however, remains unclear because the Bankruptcy Code provides an exemption only for "a security of the debtor," and the issuer pursuant to a prepack is not a "debtor" until the filing of the bankruptcy petition. In light of the current state of the law surrounding an offering of securities pursuant to a pre-packaged plan, parties should err on the side of caution and file a registration statement with the SEC.

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217. *See, e.g.*, *In re* Southland Corp., 124 B.R. 211, 225 (Bankr. N.D. Tex. 1991) ("A proponent of a prepackaged plan takes a substantial risk that . . . the Court may determine that the proposed disclosure statement or process of solicitation are inadequate").

218. 11 U.S.C. § 1126(b). The disclosure statement sets forth the terms of the plan of reorganization and the procedures for voting thereon.

219. FED. R. BANKR. P. 3018(b). A safe minimum time period of voting on a pre-packaged plan is twenty-eight days. *See* Wachtell, *supra* note 98, at 44 (reasoning that twenty-eight days is a good rule of thumb because that is the minimum time specified in Bankruptcy Rule 2002(b) for considering a disclosure statement in bankruptcy).

220. 11 U.S.C. § 1145(a)(1).

4. Pre-Negotiated Plans

Like pre-packaged plans, pre-negotiated plans are negotiated before a debtor files for bankruptcy. However, unlike prepacks, voting on pre-negotiated plans does not occur until after a bankruptcy case is filed. As a result, pre-negotiated plans are generally subject to a marginally longer bankruptcy process. Nevertheless, they provide a significant advantage over prepacks in that the parties can obtain bankruptcy court approval of the solicitation process in advance, thereby reducing the risk of a flawed solicitation.

As with prepacks, pre-negotiated plans commonly minimize certain negative externalities that arise from out-of-court transactions and the conventional Chapter 11 process, such as litigation costs, business disruptions, administrative expenses, negative publicity, and fraudulent transfer risk. Moreover, pre-negotiated plans also allow parties to reduce judicial involvement in the debtor's business affairs.

While a full vetting of "lock-up agreements" is beyond the scope of this article, in an effort to secure a successful pre-negotiated plan, parties often enter into lock-up agreements to bind key constituencies to ensure they support the plan. A lock-up agreement (sometimes referred to as a "plan support agreement") is an agreement to accept and otherwise support a particular plan of reorganization. Lock-up agreements can provide significant protections, but they are not bulletproof and may be challenged if not appropriately structured.[221]

221. *See, e.g.*, *In re* Innkeepers USA Trust, 442 B.R. 227, 232–36 (Bankr. S.D.N.Y. 2010) (denying debtor's motion to assume plan support agreement because, among other reasons, (1) the plan support agreement was not a disinterested business transaction, (2) the debtor did not enter into the plan support agreement with "due care," and (3) the debtor did not act in good faith in making the decision to enter into the plan support agreement and in providing transparency to their creditors).

CONCLUSION

While prospective purchasers of distressed energy assets have a range of options to effectuate their acquisition objectives, dealing in distressed energy assets can be complex and may involve various risks depending on the circumstances of each acquisition. As this article has shown, there are advantages and disadvantages to both out-of-court and in-court transactions, which should be evaluated by prospective purchasers with the assistance of their financial and legal advisors.

In the current environment for energy assets, there are risks and opportunities for sellers and buyers alike. The ability to transact will depend on available capital and understanding not only the business issues, but also the legal framework and processes that often come into play in distressed energy transactions.

APPENDIX

A. Key Fraudulent Transfer Cases

1. *Templeton v. O'Cheskey (In re Am. Hous. Found.)*, 785 F.3d 143 (5th Cir. Apr. 28, 2015), *as revised* (June 8, 2015).

A trustee brought actual and constructive fraudulent transfer claims pursuant to federal law to avoid and recover approximately $1 million in purportedly fraudulent transfers related to guaranties given by the debtor to the defendants and subsequent payments that the defendants received from the debtor as "returns" on their respective contributions to a limited partnership. While the lower court applied the good faith defense under Bankruptcy Code § 548(c), the Fifth Circuit found the lower court used the wrong "good faith" standard and reversed and remanded. The Fifth Circuit concluded that the lower court should not rely exclusively on its determination that a party's actions did not defraud other creditors, but should look further to whether the claimant should be on inquiry notice of the debtor's insolvency or the fraudulent nature of the transaction.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B), 548(c).

2. *Janvey v. Golf Channel, Inc.*, 780 F.3d 641 (5th Cir. 2015).

A receiver overseeing an estate brought suit to recover $5.9 million from the Golf Channel relating to an advertising contract the estate had entered into before the SEC uncovered a Ponzi scheme. The lower court determined that although the estate's payments to the Golf Channel were actual fraudulent transfers under state law, the Golf Channel was entitled to judgment as a matter of law on its affirmative defense under TUFTA that it received the payments in good faith and in exchange for reasonably equivalent value (the market value of advertising on The Golf Channel). On review, the Fifth Circuit rejected the argument that "reasonably equivalent value" was exchanged and held that Golf Channel's services provided no value to the creditors of the estate, and, further, the advertising services did not provide even a speculative economic benefit to the creditors, regardless of the market value of the services. Thus, the Golf Channel's affirmative defense to an actual fraudulent transfer under TUFTA was not established.[222]

222. This TUFTA "*Erie*" ruling appears to conflict with the precedent set forth in *Williams v. FDIC* (*In re Positive Health Mgmt.*), 769 F.3d 899 (5th Cir. 2014), summarized *infra*, interpreting the analogous good-faith, for-value defense under Bankruptcy Code § 548(c), as looking to the value given from the viewpoint of the transferee.

Applicable Statute: TEX. BUS. & COM. CODE ANN. §§ 24.005(a)(1), 24.009(a) (2015).

3. *Williams v. FDIC (In re Positive Health Mgmt.)*, 769 F.3d 899 (5th Cir. 2014).

A trustee brought claims of actual and constructive fraudulent transfers under § 548 for rent payments made by the debtor to a lender on a loan that was made to another entity and secured by property that the debtor used for office space. The lower court held there was no constructive fraud since the debtor received reasonably equivalent value based on the value received for continuing operations without foreclosure and for a "reasonable rent" for the office space. While the lower court found actual fraud based on an "actual intent to hinder, delay or defraud" creditors, the lower court found that the affirmative defense of good faith, for value pursuant to Bankruptcy Code § 548(c) applied because the lender: (1) acted with good faith and (2) gave "value" in exchange for the payments. The Court relied on its prior holding in *In re Hannover Corp.*, 310 F.3d at 799-802, that value for purposes of the good faith, for value affirmative defense is considered from the transferee's perspective. The Fifth Circuit affirmed the good faith affirmative defense but only to the extent that the transferee gave value to the debtor in exchange for the transfer. The Fifth Circuit applied a "netting" approach, holding that Bankruptcy Code § 548(c) required the court to reduce the value of the fraudulent transfers by the value of the market rent, and to award the estate the difference.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B), 548(c).

4. *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014).

A parent company acquired the debtor entity by means of a leveraged buyout (LBO) in which the debtor company financed the entire purchase, taking on approximately $21 billion of secured indebtedness, of which $12.5 billion was paid out to stockholders of the then-debtor-to-be. The debtor company filed for bankruptcy thirteen months later, and when its creditors found themselves ranking behind the LBO secured lenders, the creditors filed actual and constructive fraudulent transfer claims under state law. The court held that: (1) the Bankruptcy Code § 546(e) defense did not apply to state law fraudulent transfer claims not asserted under any Bankruptcy Code provision, and state law fraudulent transfer claims are not preempted by the Bankruptcy Code; (2) where the transaction was collapsed and considered based upon economic substance, the transfers were deemed to be property of the debtor;

(3) nominee, non-beneficial holders of stock cannot be held liable for fraudulent transfers; (4) a creditor's trust cannot sue on behalf of creditors who ratified the transfers (but can sue on behalf of those who did not ratify); and (5) although evidence supporting allegations of actual fraud were deficient, the Court dismissed with leave to amend pleadings.

Applicable Statute: State Law, but the court cited no specific statute and noted that "[t]he particular state law is not relevant to these motions, if it ever will be. State fraudulent transfer law is largely, but not entirely, the same throughout the United States . . . ."]

5. *Tronox Inc. v. Kerr McGee Corp. (In re Tronox, Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013).

After a spinoff in 2006, the debtor retained substantial legacy, environmental, and tort liabilities that accrued over the course of seventy years, while the debtor's valuable oil and gas exploration and production business was transferred into a new entity. A few months after the spinoff, a third party purchased the newly-formed entity's recently acquired exploration and production business for $18 billion. The debtor subsequently filed for bankruptcy in 2009. Regarding actual fraud, the court found numerous "badges of fraud" and determined that the defendants lacked a good faith belief that the debtor would be able to support the liabilities that had been imposed on it after the spinoff. Thus, actual fraudulent intent to delay or hinder creditors was established under state law. Regarding constructive fraud, the court, after considering all related transactions together as a single transaction and analyzing market evidence, contingent liabilities, and asset valuation, held that the debtor did not receive "reasonably equivalent value" in the transaction. Based on numerous factors, the court found that the debtor was insolvent and unreasonably capitalized and that the defendants reasonably should have believed that the debtor would be unable to pay its debts as they became due. Thus, constructive fraud was also established under state law.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B); Okla. Stat. tit. 24, §§ 116(A)(1), 116(A)(2), 117(A) (2015).

6. *Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors* (*In re TOUSA, Inc.*), 680 F.3d 1298 (11th Cir. 2012).

A parent company paid a $421 million debt settlement to a third party transferee with the proceeds of a loan that was secured primarily by assets of the parent company's subsidiaries even though the subsidiaries were not obligors on the debt to the third party transferee. Six months later, the parent company and the subsidiaries declared bankruptcy. The Eleventh Circuit held that the bankruptcy court did not err when it found transfer of the liens to the new lenders was constructively fraudulent pursuant to Bankruptcy Code § 548(a)(1)(B) because the subsidiaries did not receive "reasonably equivalent value" for the liens. The Eleventh Circuit did not define "value" but did find that benefits to the parent and the corporate family did not necessarily convey value to the subsidiary.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B).

7. *Kaye v. Lone Star Fund V (U.S.), L.P.*, 453 B.R. 645 (N.D. Tex. 2011).

A parent company spun-off a subsidiary, and the subsidiary sued for actual and constructive fraudulent transfers under both federal and state law. Specifically, the subsidiary alleged that the parent company transferred various financial burdens to the subsidiary in an effort to improve the parent company's marketability. In considering a motion to dismiss, the court ruled that constructive fraud was adequately pled based on proceeds flowing to the parent without reasonably equivalent value in return. With respect to actual fraud, the court found that the claim was adequately pled based on the following three badges of fraud: (1) transfers were to an insider, (2) the debtor received less than reasonably equivalent value, and (3) the debtor was insolvent.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B); ALA. CODE §§ 8-9A-4(a), 8-9A-4(c), 8-9A-5(a) (2015).

8. *U.S. Bank Nat'l Assn. v. Verizon Commc'ns. Inc. (U.S. Bank Nat'l Assn. Litigation)*, 817 F. Supp. 2d 934 (N.D. Tex. 2011).

A parent company spun-off a subsidiary whose balance sheet reflected that its debt exceeded its assets by approximately $9 billion after the spinoff. The subsidiary subsequently filed for bankruptcy twenty-eight months later. The subsidiary's trust brought claims for actual and constructive fraudulent transfers under state and federal law. While the court found certain badges of

fraud to be present, the court ultimately found that the subsidiary was solvent as of the date of the spinoff, that there was no direct evidence of fraudulent intent, and that there were insufficient badges of fraud as a matter of law to prove an actually fraudulent transfer. The constructive fraudulent transfer claims also failed, as the court found that there was no effective difference between the insolvency analysis and the reasonably equivalent value analysis, and, since the subsidiary was solvent based on total enterprise value, the subsidiary received reasonably equivalent value.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) – (B); TEX. BUS. & COM. CODE ANN. §§ 24.005(a)(1) – (2).

9. *The Liquidation Trust v. Daimler AG (In re Old Carco LLC (f/k/a Chrysler LLC))*, 454 B.R. 38 (Bankr. S.D.N.Y. 2011).

A liquidation trust asserted fraudulent transfer claims based on a former parent company's alleged intention to strip valuable assets away from the debtor before selling its controlling interest in the debtor. The court found that the trust did not sufficiently take into account all elements of value received in the overall transaction and held that the constructive fraudulent conveyance claims under federal and state law were properly dismissed because of the trust's undervaluation and omission of various disputed consideration elements.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B); N.Y. DEBT. & CRED. LAW § 273 (2015).

10. *ASARCO LLC v. Ams. Mining Corp.*, 396 B.R. 278 (S.D. Tex. 2008).

The debtor sued its parent corporation to challenge a transfer under which the parent company received valuable stock assets of the debtor. Regarding constructive fraud, the court looked to Delaware law and analyzed whether "reasonably equivalent value" was given in exchange for the asset. Upon completing its valuation, the court found that, under the totality of the circumstances, the debtor received eighty-five to ninety percent of the value of the asset, which constituted "reasonably equivalent value." As to actual fraud, the court found that the parent company did not properly market the stock to the highest bidder, removed the "crown jewel" asset from the estate, concealed information, broke promises, and closed the transaction over the objections of the independent directors with knowledge that the transaction would hinder and delay the debtor paying other creditors. Accordingly, the court found actual fraud and entered a judgment valued at over $6 billion against the parent company.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) –(B); 6 DEL. CODE ANN. tit 6, §§ 1304(a)(1) –(2) (2015), 1305(a) (2015).

11. *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007).

A parent company spun-off a subsidiary and sold it several food companies. The subsidiary financed the purchase by taking on new secured debt and issuing a dividend to the parent's shareholders upon the becoming an independent company. The subsidiary filed for bankruptcy within three years and sued the parent, asserting, *inter alia*, a constructively fraudulent transfer claim. The Third Circuit affirmed the lower court's rejection of the claim because (1) the food companies were worth well in excess of the amount the subsidiary paid for them at the time of the spin-off, (2) market valuation was sufficient to show the food companies were solvent at the time of the spin-off, and (3) "reasonably equivalent value" was exchanged.

Applicable Statute: N.J. STAT. ANN. §§ 25:2-25(b), 25:2-27(a) (2015).

12. *Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

A creditors' committee brought suit to set aside transfers totaling approximately $3.7 billion from the debtor to its parent company during the four years leading up to the debtor's bankruptcy. At issue was whether certain transfers were voidable fraudulent transfers or preferences, with a focus on whether the debtor was either insolvent or inadequately capitalized at the time the challenged transfers were made. The court determined that the "voluminous and compelling" contemporaneous market value of the debtor's securities was consistent with "substantial enterprise value" and was "inconsistent with insolvency." The court further determined that looking back at the market with "hindsight bias" in valuing the entity for purposes of insolvency was inappropriate because "the public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the court, is the preferred standard of valuation." *Id.* at 293. The court held that the plaintiff had not carried its burden to prove either insolvency or unreasonably small capital and dismissed all fraudulent transfer claims.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B); D.C. CODE § 28 –3102 (2015).

13. *Jimmy Swaggart Ministries v. Hayes* (*In re Hannover Corp.*), 310 F.3d 796 (5th Cir. 2002).

The trustee argued before the Fifth Circuit that the debtor's transfers to a third party under an option agreement for the purchase of real estate could be avoided as actual and constructive fraudulent conveyances under federal law. The district court had reversed the bankruptcy court's ruling that the transferee had taken the transfer in good faith and for value. The Fifth Circuit reversed the district court and found that the bankruptcy court was entitled to deference regarding its determination that the good faith, for value affirmative defense had been established under Bankruptcy Code § 548(c). The Fifth Circuit determined that the transferee acted in good faith and that (1) the call options had value from the perspective of the transferee, (2) the value was determined at the time of origination, and (3) the debtor's practical inability to exercise the option is irrelevant to its valuation for purposes of the good faith, for value affirmative defense under Bankruptcy Code § 548(c).

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) – (B), 548(c).

B. Glossary of Commonly Used Chapter 11 Bankruptcy Terms

Note: The following definitions are provided to assist the reader in understanding some of the terms used in Chapter 11 proceedings generally. For more detailed and exact definitions, please review the Bankruptcy Code and consult with legal counsel.

Administrative Claims: Fees of court-authorized professionals, trustee's commissions, and claims of trade creditors and others for credit extended after the entry of the order for relief. Administrative claims generally are entitled to priority and must be paid before claims of any prepetition unsecured creditors.

Anti-Assignment Clause: A provision in a contract that restricts or prohibits the transfer or assignment of interests in an executory contract or unexpired lease.

Automatic Stay: When a Chapter 11 petition is filed, creditors are automatically prohibited from attempting to collect their prepetition claims from the debtor or proceeding against property of the debtor without first obtaining permission from the court to do so.

Cash Collateral: Cash and cash equivalents that serve as collateral for a secured creditor's claim. Included in this category are cash, bank deposits, proceeds from the sale of assets, accounts receivable collections, and rents.

Class of Creditors: Creditors must be divided into classes in a plan of reorganization. The claims of general unsecured creditors are frequently grouped together as one class, but there may exist sufficient distinctions among the general unsecured creditors that justify dividing them into multiple classes.

Confirmation: The approval by the court of a plan of reorganization.

Consensual Plan: A plan of reorganization accepted by every class of creditors and equity holders. It is rare for a consensual plan not to be approved by a bankruptcy court.

Conversion: The Bankruptcy Code, in general, allows a debtor to reorganize under Chapter 11 or to be liquidated under Chapter 7. A case may be changed, or converted, from administration under one chapter to administration under another by court order or upon the request of the debtor, any creditor, the United States Trustee, or any other party in interest. Creditors will often move to convert a Chapter 11 case to Chapter 7 if it does not appear that the debtor will be able to successfully reorganize, or if they think they would recover more in liquidation than under a reorganization.

Cramdown: Confirmation of a plan of reorganization over the objection of a class of creditors or equity holders. Cramdown may occur only if at least one class of creditors whose claims are impaired by the plan votes to accept it. The court will cramdown a plan on a dissenting class only if it finds that the plan does not discriminate unfairly against that class and is fair and equitable as to that class.

Debtor: The entity undergoing reorganization.

Debtor in Possession: Unless and until a trustee is appointed, a debtor remains in possession of its assets and will manage its own affairs. The debtor in possession has a fiduciary obligation to its creditors, much the same as a court-appointed trustee.

Discharge: The release of claims against the debtor.

Disclosure Statement: When creditors are solicited to vote on a plan, they will receive the plan or a plan summary (if approved by the court), a ballot, and a disclosure statement. The disclosure statement is intended to give creditors adequate information about the debtor and the plan to permit them to make an informed judgment as to whether to vote for or against the plan. The debtor cannot send the disclosure statement to creditors until it has been approved by the bankruptcy court, after notice and a hearing.

Examiner: A person appointed by the court, upon a motion of creditors or the United States Trustee, to look into the debtor's books and records and dealings with third parties. The scope of the examiner's duties are established by the court. The report prepared by the examiner is usually filed with the court and maintained as a public record.

Fraudulent Transfer (or Conveyance): Transfers or conveyances that are deemed to be in fraud of creditors, either actually or constructively, may be

avoided under state law and/or the Bankruptcy Code by the debtor in possession or by the trustee.

General Unsecured Claims: Those unsecured claims that are neither administrative nor priority claims.

Involuntary Petition: Three or more creditors (or one creditor, if a debtor has fewer than twelve creditors) with undisputed, liquidated claims can put a debtor into bankruptcy by filing an involuntary petition if the debtor is not paying its debts generally as they become due. The bankruptcy court will give the debtor a chance to respond to the involuntary petition and then will hold a hearing on the involuntary petition. If the petitioning creditors prove their case, the bankruptcy court will enter an order for relief against the debtor.

Lockup Agreement: An agreement between parties that binds creditors or other parties to the terms of a negotiated restructuring that is a common feature of out-of-court pre-packaged workout plans.

Order for Relief: The declaration that the debtor's business is subject to the court's jurisdiction. In a voluntary case, an order for relief is automatically entered when the petition is filed. In an involuntary case, an order for relief can only be entered after giving the debtor the opportunity to defend the allegations in the petition.

Petition: The documents filed with the bankruptcy court that initiate a bankruptcy case.

Plan of Reorganization: Sometimes referred to by the shortened term "plan," the document that, when approved by the bankruptcy court, specifies the treatment of the claims of the debtor's creditors. A confirmed plan is binding on all creditors—even those who did not vote in favor of the plan. Where the debtor's assets are liquidated in a Chapter 11 case, this document will instead be called a plan of liquidation.

Preference: Payments made to creditors within 90 days prior to the filing of a petition on account of pre-existing debts may, under some circumstances, be avoided by the debtor in possession or trustee. The ninety-day period is extended to one year if the creditor is an insider of the debtor. A creditor's committee may be instrumental in pursuing preference claims, particularly preference claims against insiders of the debtor.

Preferential Rights: The rights provided to a third party by the terms of an executory contract or unexpired lease, which grant the party the first opportunity to purchase or assert some preference. Preferential rights are also known as rights of first refusal or preemptive rights.

Priority of Claims: Prepetition unsecured claims that are entitled to be paid before the claims of the general unsecured creditors. The most common priority claims are for wages, employee benefits, customer deposits, and taxes.

Proof of Claim: The document filed with the bankruptcy court by a creditor that establishes the amount and basis of its claim.

Rule 2004 Examination: A procedure, similar to a deposition, for obtaining information from the debtor and third parties about the assets and liabilities of the debtor and other matters relevant to a case. The party being examined is asked questions under oath before a stenographer, who prepares a written transcript of the examination. The party may also be required to produce documents relevant to the case.

Schedules: A document filed with the bankruptcy court by a debtor setting forth its assets and liabilities in detail.

Section 341 Hearing: Commonly referred to as the first meeting of creditors, the debtor appears at an informal hearing, which, in a Chapter 11 case, is conducted by the United States Trustee. All creditors are entitled to ask the debtor questions about its business, its assets and liabilities, and other matters relevant to the reorganization.

Secured Creditor: A creditor whose claim is backed by collateral.

Solvency (or Valuation) Opinion: A third party expert opinion that evaluates assets or transactions with a distressed company.

Statement of Financial Affairs: A document filed with the bankruptcy court by a debtor that sets forth certain information about the debtor's business, management, and finances. The statement of financial affairs is normally filed simultaneously with the schedules.

Super-Priority Administrative Claim: A type of administrative claim that has priority over other administrative claims. Super-priority administrative claim status is often granted to a secured lender in connection with a cash collateral or borrowing stipulation.

Trustee: A person who may be appointed by the United States Trustee, who is entrusted with the responsibility of managing the debtor's business, pursuing claims against third parties, and maximizing the payment to creditors through a reorganization or, if appropriate, a liquidation of the business. In a Chapter 11 case, a trustee is appointed only upon court order after motion by a creditor, the United States Trustee, or another party in interest. Grounds for appointment of a trustee include fraud, dishonesty, or gross mismanagement by the debtor.

United States Trustee: An officer of the United States Department of Justice responsible for monitoring Chapter 11 cases. The *United States Trustee* is responsible for appointing trustees and presiding at the Section 341 hearing. The *United States Trustee* has the right to be heard on any matter coming before the bankruptcy court and to file motions with the bankruptcy court in furtherance of its duties.

Voluntary Petition: A petition filed by the debtor. Most Chapter 11 cases are commenced by the filing of a voluntary petition.

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I. INTRODUCTION

Energy production in the United States continues to outpace expectations with an estimated oil production surge of 46% from 2011 to 2014 to the highest levels since 1972. Likewise, production of natural gas in the United States has grown dramatically.[1] These increases have been driven by technology and innovation in the field by those who take the risks in search of the rewards offered by successful exploration and production, and fracking has been one of the core drivers of the current advances in production.[2] These developments have been breathtaking. Increased production in the United States has changed the world energy equation, with the United States having overtaken Saudi Arabia as the largest producer of oil in the world.[3] Commodities can be volatile in their pricing, and it is axiomatic that increased supply without a commensurate increase in demand can lead to lower prices.[4] Externalities impacting prices, although often buffered by various derivative transactions, can also lead to challenging economics and, in some cases, the need for restructuring or reorganization of an affected company's financial affairs.[5] This Article will examine many of the key issues that arise in restructurings and reorganizations of energy companies, including upstream, midstream, and downstream companies.

Energy companies facing excess leverage or insufficient cash flow may pursue restructuring strategies out of court and, if necessary, reorganization in court by filing for bankruptcy, most often under Chapter 11 of the United States Bankruptcy Code (Bankruptcy Code).[6] Distressed energy companies will often have alternatives to bankruptcy such as debt modifications, debt refinancings, debt exchanges, asset sales to raise liquidity, equity recapitalizations, forbearance arrangements, and other debt restructuring tools. While the involvement of specific players in any energy restructuring or reorganization will depend on the energy sector and structure, generally speaking, common players in an energy restructuring or reorganization include the company as debtor, management, secured lenders, bondholders, potential asset purchasers, trade vendors, service vendors, oil and gas lessors, contract counterparties under joint operating agreements (JOAs), derivatives counterparties, co-

1. Timothe Puko & Christian Berthelsen, *Natural-Gas Prices Drop on Greater-Than-Expected Surplus*, WALL ST. J. (July 10, 2014), http://online.wsj.com/articles/natural-gas-prices-drop-on-greater-than-expected-surplus-1405004266.

2. Chip Register, *Technology Is The New Black In The Energy Economy*, FORBES MAGAZINE (July 24, 2014), http://www.forbes.com/sites/chipregister1/2014/07/24/technology-is-the-new-black-in-the-energy-economy/.

3. Grant Smith, *U.S. Seen as Biggest Oil Producer After Overtaking Saudi Arabia*, BLOOMBERG NEWS (July 4, 2014), http://www.bloomberg.com/news/2014-07-04/u-s-seen-as-biggest-oil-producer-after-overtaking-saudi.html.

4. Glenys Sim, *Goldman Forecasts Lower Commodity Prices as Cycle Ends*, BLOOMBERG NEWS (July 16, 2014), http://www.bloomberg.com/news/2014-07-16/goldman-sees-lower-commodity-prices-over-five-years-on-supplies.html.

5. As used in this Article, "restructuring" refers generally to out-of-court processes, and "reorganization" refers generally to in-court processes, most notably, cases under Chapter 11 of the United States Bankruptcy Code.

6. The Bankruptcy Code is codified as 11 U.S.C. §§ 101–1532 (2012).

working interest owners, farmors, farmees, production payment counterparties, first purchasers, and equity holders. Additionally, the Bankruptcy Code provides standing under appropriate circumstances for statutory committees of creditors and equity holders, and potentially for appointment of a bankruptcy trustee or examiner.[7]

Eligible entities[8] may use Chapter 11 of the Bankruptcy Code to reorganize their financial affairs. A bankruptcy court provides a forum for dispute resolution of financial distress and enables an eligible company to obtain a breathing period from creditors pursuant to the automatic stay, to borrow funds or use cash collateral on a post-petition basis to fund its business, and to reorganize and discharge debts via a reorganization plan to obtain a fresh start. The Bankruptcy Code permits "section 363" asset sales free and clear of claims and interests providing purchasers with an open forum for bidding and a "free and clear" asset transfer.[9] Finally, a plan of reorganization provides an eligible debtor with a broad menu of options to reorganize, including restructuring its debts, merging entities, selling assets outright or synthetically, issuing securities, separating operating assets from liquidation and litigation assets, jettisoning burdensome agreements, and emerging with a new set of contracts under which to continue operating its business.

II. BANKRUPTCY ISSUES COMMON THROUGHOUT THE ENERGY INDUSTRY

A. Commencing the Bankruptcy Case and the Bankruptcy Code Generally

A number of common issues impact Chapter 11 energy cases, including:

a) commencement of the case by the filing of a bankruptcy petition (whether voluntary or involuntary), which triggers application of the automatic stay injunction (and exceptions thereto) under Bankruptcy Code § 362;

b) first day hearings to facilitate interim relief for transitioning into bankruptcy and minimizing business interruptions, obtaining credit financing, and facilitating ongoing operation of the business;

7. 11 U.S.C. § 1104.

8. Individuals, corporations, partnerships, and other business organizations such as limited liability companies are eligible to be debtors under Chapter 11. *See* 11 U.S.C. §§ 109(d), 101(41). Typically organized as partnerships, a master limited partnership (MLP) is eligible to be a debtor under Chapter 11. MLPs are a growing and significant part of the energy industry. An energy company organized as an MLP does not necessarily raise unique bankruptcy issues. Rather, the particular considerations of an MLP and the segment of the industry in which it operates will drive a bankruptcy filing and the issues in the bankruptcy case.

9. 11 U.S.C. § 363(f).

c) obtaining credit called debtor-in-possession (DIP) financing and using cash collateral under Bankruptcy Code §§ 364 and 363, respectively;

d) asset sales via Bankruptcy Code § 363;

e) assumption and rejection of executory contracts and unexpired leases per Bankruptcy Code § 365;

f) valuation of bankruptcy estate property per Bankruptcy Code § 506;

g) avoidance "clawback" actions (including fraudulent transfer, "strong arm" avoidance, and preference proceedings) under Chapter 5 of the Bankruptcy Code;

h) derivatives contracts continuance or termination;

i) regulatory matters affecting the estate; and

j) plan of reorganization under Bankruptcy Code § 1129.

Certain provisions of the Bankruptcy Code apply uniquely or more specifically in energy reorganizations, including provisions relating to farmout agreements, production payments, certain types of hedges and derivatives, certain regulatory exemptions from the automatic stay, and prohibitions on the sale of a co-owner's property interest.

B. "First Day" Proceedings

Upon the commencement of a bankruptcy case, a debtor typically files pleadings that are commonly called "first day" motions.[10] The purpose of first day motions is to facilitate a debtor's transition into Chapter 11 by providing a wide range of relief that the Debtor believes is necessary or prudent in order to maintain operations and efficiently manage its bankruptcy case.[11]

The type of relief sought by debtors through first day motions varies depending on the type of business, the needs of the business, and the exigencies of the bankruptcy case. Some examples of first day motions include motions to:

a) obtain joint administration of related bankruptcy cases involving affiliates so that the bankruptcy of related entities can be administered on one case docket rather than several;

10. James H.M. Sprayregen, P.C. et al., *First Things First—A Primer on How to Obtain Appropriate "First Day" Relief in Chapter 11 Cases*, 11 J. BANKR. L. & PRAC. 275, 302 (2002).

11. *Id.* at 276.

b) authorize the employment of professionals and establish procedures for approval of professional fees;

c) approve cash management systems;

d) honor employee benefit programs such as vacation policies and health insurance;

e) authorize the payment of critical vendors;

f) authorize adequate assurance of payment for utilities to ensure continued service; and

g) obtain credit via debtor-in-possession financing and/or use of a secured creditor's cash collateral to enable the Debtor to have cash to operate its business during the bankruptcy case.[12]

Additionally, energy companies may require certain unique relief as a first day matter. For example, and as discussed more fully below, the failure to pay royalties may cause an oil and gas lease to terminate automatically due to a specific provision in the lease or applicable state law.[13] Thus, energy companies may need to consider seeking authority to continue to pay both pre-petition and post-petition royalties to prevent automatic lease termination.

Prior to the filing of a bankruptcy case, energy companies should consider what immediate relief may be vital for the company to continue its operations and preserve value for its creditors and stakeholders. While the first day motions listed above are typically utilized, every bankruptcy case is unique, and first day motions should be crafted to address the specific circumstances of the particular debtor.

C. The Automatic Stay

A fundamental element of any bankruptcy case is the automatic stay. The automatic stay set forth in Bankruptcy Code § 362 is a federal injunction which generally prevents creditors from enforcing debts against the Debtor,[14] perfecting security interests against the Debtor,[15] continuing pending litigation, or bringing a new suit against the Debtor in a forum other than the bankruptcy court in an adversary proceeding.[16] Parties that violate the automatic stay may

12. Jay M. Goffman & Grenville R. Day, *First Day Motions and Ordering in Large Chapter 11 Cases: (Critical Vendor, DIP Financing and Cash Management Issues)*, 12 J. BANKR. L. & PRAC. 6 ART. 3 (2003).

13. *See infra* Part III.C.

14. 11 U.S.C. § 362(a)(2).

15. *Id.* § 362(a)(4).

16. *Id.* § 362(a)(1). An adversary proceeding is a discrete and numbered proceeding within the overall bankruptcy case. FED. R. BANKR. P. 7001 (2010).

face actual damages or, in some cases, punitive damages.[17]

The automatic stay gives the Debtor breathing room to assess reorganization or liquidation options. Instead of a "race to the courthouse" whereby creditors scramble to collect for themselves ahead of other creditors, Chapter 11 is a collective proceeding whose goal is an impartial, court-approved plan to reorganize or liquidate. The automatic stay merely delays enforcement of the rights of creditors; it does not necessarily expunge or modify such rights permanently. In order to enforce or protect a right subject to the automatic stay, creditors may petition the court to lift the stay for "cause," including a lack of adequate protection of a creditor's property interest or, in the case of a creditor's desire to act (such as to foreclose) against property of the Debtor, on the grounds that the Debtor does not have equity in the property and the property is not necessary to an effective reorganization.[18]

Notwithstanding the broad scope of the automatic stay, the Bankruptcy Code also contains several exceptions that are frequently relevant to typical stakeholders in the bankruptcy cases of energy companies, such as parties to certain types of derivatives contracts and regulatory bodies seeking to enforce legal mandates. These exceptions are further discussed herein.

D. Debtor-in-Possession Financing and Use of Cash Collateral

Upon filing for bankruptcy, a debtor will require cash to both run its business and effectuate a reorganization process. Bankruptcy Code § 364 provides several structures for debtors to obtain credit. Bankruptcy Code §§ 364(a) and (b) permit the Debtor to borrow or otherwise incur credit on an unsecured basis with the lender receiving an administrative expense claim.[19] If the Debtor is unable to obtain unsecured credit in exchange solely for an administrative expense claim, Bankruptcy Code § 364(c) provides that the Debtor can borrow by means of granting the lender's claim priority over other administrative expenses, a lien on otherwise unencumbered property, or a junior lien on encumbered property.[20]

In the event that borrowings on an unsecured or priority basis cannot be obtained, the Debtor can also borrow on the basis of a senior or equal lien on previously encumbered property pursuant to Bankruptcy Code § 364(d) so long as the Debtor can show it is unable to obtain credit otherwise and provides adequate protection to the holder of existing interests.[21] Secured creditors that

17. 11 U.S.C. § 362(k); *see* St. Paul Fire & Marine Ins. Co. v. Labuzan, 579 F.3d 533, 539 (5th Cir. 2009) (a creditor may have standing to sue another entity for damages for violation of the automatic stay).

18. 11 U.S.C. § 362(d)(2). Pursuant to 11 U.S.C. § 361, adequate protection against a decrease in value of a creditor's interest in estate property can be provided in a number of fashions such as cash payments, new or replacement liens, substitute collateral, or other relief that will result in the realization by such entity of the indubitable equivalent of its interest in estate property. *Id*. at § 361.

19. 11 U.S.C. § 364(a)–(b).

20. *Id.* § 364(c).

21. *Id.* § 364(d).

can potentially be primed by debtor-in-procession (DIP) financing in an energy bankruptcy include mechanic's and materialman's lien holders, royalty and first purchaser lien holders, JOA lien holders, and pre-petition lenders.[22] To determine adequate protection, the court values the current secured claim holder's interests at the time of the hearing,[23] and the burden of proving adequate protection is on the Debtor seeking the financing.[24] This is a material burden, as courts can be reluctant to prime the bargained-for lien of a secured creditor.[25] As a result, experience has shown that obtaining court approval of priming DIP facilities can be challenging in the face of active opposition by other secured creditors.

It is important to note that, pursuant to Bankruptcy Code § 510, pre-petition subordination agreements are enforceable in bankruptcy cases,[26] and such agreements have impacted the ability of pre-petition secured creditors to provide DIP financing. Typical intercreditor agreements include a number of provisions that contemplate possible future DIP financing, including provisions providing for a waiver by a subordinated creditor of its right to object to a senior creditor's priming DIP lien, an agreement by the subordinated creditor not to provide DIP financing on a priming basis, a waiver of a subordinated creditor's right to receive adequate protection except in narrow circumstances or to contest the entitlement of a senior creditor to adequate protection, and negotiated caps on the amount of total financing of a senior creditor (pre- and post-petition) that can be made without objection or challenge by the subordinated creditors.

Negotiated terms of DIP loans in an energy reorganization often include:

a) size of commitment and draw limitations;

b) interest rate, fees, and payment timing;

c) non-debtor guarantors and other credit support;

d) collateral terms;

   i. broad collateral description;

   ii. assets to be excluded;

   iii. whether to seek Chapter 5 (avoidance) causes of action as

22. *See id.* § 364(c)–(d).

23. *See In re* Levitt & Sons, LLC, 384 B.R. 630, 643–644 (Bankr. S.D. Fla. 2008).

24. 11 U.S.C. 364(d)(2); *see In re* YL W. 87th Holdings I, LLC, 423 B.R. 421, 441 n.44 (Bankr. S.D.N.Y. 2010).

25. *See In re YL W. 87th Holdings*, 423 B.R. at 441 (citing *In re* Seth Co., 281 B.R. 150, 153 (Bankr. D. Conn. 2002)).

26. 11 U.S.C. § 510.

collateral;

iv. representations as to title to collateral and priority of DIP liens; and

v. terms as to prior existing liens;

e) budget;

i. sources and uses;

ii. variance tolerance;

iii. capex for well drilling/workovers/well elections to prevent going non-consent or other capital improvements;

iv. lease preservation payments such as delay rentals;

v. payment of pre-petition critical vendors, royalty creditors, or trade claims;

vi. compensation and overhead;

vii. collateralizing bonds with regulatory agencies;

viii. adequate protection payments;

ix. interest and fees of DIP lender; and

x. carve-out for case professionals;

f) milestones regarding conduct of case;

g) maintenance and insurance of assets;

h) releases and indemnities;

i) surcharge and marshalling waiver;

j) defaults and remedies upon default; and

k) maturity.

In addition to borrowing to fund the reorganization process, the Bankruptcy Code permits a Debtor to use the cash collateral of its secured creditors subject

to the Debtor providing adequate protection. Generally speaking, Bankruptcy Code § 363(c) authorizes the Debtor to use, sell, or lease property of the estate in the ordinary course of business without the need for notice or a hearing if the continued operation of the business is authorized and the court does not order otherwise.[27] However, this general rule has an exception when the property is cash collateral.[28] Recognizing that cash and cash equivalents are easily dissipated, the Bankruptcy Code places limitations on a debtor's ability to use such property.

Bankruptcy Code § 363(a) defines cash collateral as:

> cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property . . . subject to a security interest as provided in section 552(b) of [the Bankruptcy Code], whether existing before or after the commencement of a case under this title.[29]

The term "security" is defined in Bankruptcy Code § 101 to include a variety of investment claims or interests, including stocks, bonds, notes, and interests in limited partnerships.[30] Because securities are included in the definition of cash collateral, a debtor is subject to the rules with respect to cash collateral when seeking to use or sell pledged securities.[31] Bankruptcy Code § 363(c)(2) provides that the Debtor may not use, sell, or lease cash collateral without either (1) the consent of the creditor with an interest in the collateral or (2) court authorization granted after notice and hearing.[32] In the absence of the creditor's consent, the Debtor may use cash collateral only with the approval of the court, which requires adequate protection of the creditor's interests in the cash collateral.[33]

E. Asset Dispositions; The § 363 Sale

As noted above, the Debtor generally may use its assets and operate its business in the ordinary course. In addition, the Bankruptcy Code enables debtors to operate their business and sell assets to raise funds. This authority to use, sell, or lease assets is an important power in a bankruptcy proceeding because it permits the energy debtor to dispose of unprofitable or unneeded assets, to fund its case and pay essential creditors, and operate its business to maximize the value of its property.

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27. *Id.* § 363(c)(1).
28. *Id.* § 363(c)(2).
29. *Id.* § 363(a).
30. *Id.* § 101(49).
31. *Id.* § 363(a).
32. *Id.* § 363(c)(2).
33. *Id.* § 363(e).

The Debtor may sell property under Bankruptcy Code § 363(f) free and clear of any interest in such property of an entity other than the estate, only if:

> (1) applicable nonbankruptcy law permits the 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.[34]

At any time, on request of an entity that has an interest in property that is or will be used, sold, or leased by the Debtor, the court is required to prohibit or condition such use, sale, or lease as necessary to provide adequate protection of that interest.[35] The Debtor has the burden of proof on the issue of adequate protection, but the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.[36]

The Bankruptcy Code provides several features for bankruptcy sales that are attractive to potential buyers. First, unless the court for cause orders otherwise, the holder of a secured claim may credit bid at a 363 sale on property in which it has an interest and offset its secured claim against the purchase price of the property acquired.[37] Second, the reversal or modification on appeal of an authorization of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased property in good faith, whether or not the entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.[38] This "statutory mootness" assures buyers that they can rely on the finality of bankruptcy 363 sales.

Bankruptcy Code § 363(n) provides that a sale must be non-collusive, and the Debtor may set aside a sale if the sale price was controlled by an agreement among potential bidders, or it may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which the sale was consummated plus any costs, attorney's fees, or expenses incurred by the Debtor.[39] In addition, the court may grant judgment for punitive damages

34. *Id.* § 363(f).
35. *Id.* § 363(e).
36. *Id.* § 363(p).
37. *Id.* § 363(k).
38. *Id.* § 363(m).
39. *Id.* § 363(n).

in favor of the estate and against any such party that willfully disregards this rule.[40]

F. Assumption and Rejection of Executory Contracts and Unexpired Leases

Bankruptcy Code § 365 allows a debtor to assume its beneficial "executory" contracts and unexpired leases and to reject those that are burdensome to the estate. An executory contract is generally a contract under which material performance is still due on both sides.[41] Whether an agreement constitutes an "unexpired lease" is determined by state law.[42] The Debtor can enforce the terms of qualifying executory contracts and unexpired leases against the non-Debtor party before (and after) assumption or up until rejection, but the Debtor is protected from having the terms of the contract enforced against it by a counterparty, absent the counterparty obtaining court relief.[43]

A debtor may not assume or reject a contract without consequence. To assume an executory contract or unexpired lease, the Debtor is required to "cure" defaults to the extent provided in Bankruptcy Code § 365, including defaults that arose before and after the petition date, and the Debtor must also provide adequate assurance of future performance.[44] Following assumption, the contract will be enforceable pursuant to its terms.[45] The Bankruptcy Code also permits the assumption and assignment to a third party of executory contracts and unexpired leases notwithstanding contractual provisions that might otherwise limit assumption or assignment.[46]

Rejection of an executory contract that has not previously been assumed constitutes a breach of the contract or lease as of immediately prior to the petition date.[47] Consequently, the non-Debtor party will typically have an

40. *Id.*

41. *Id.* § 365(a). The majority of courts hold that an agreement is executory if at the time of the bankruptcy filing the failure of either party to complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party. Ocean Marine Servs. P'ship No. 1 v. Digicon, Inc. (*In re* Digicon, Inc.), 71 Fed. App'x 442, at *5 (5th Cir. June 11, 2003); Murexco Petroleum, Inc. v. Phoenix Exploration, Inc. (*In re* Murexco Petroleum, Inc.), 15 F.3d 60, 62–63 (5th Cir. 1994). This is commonly known as the "Countryman" definition of executory contracts. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 458–62 (1973); Vern Countryman, *Executory Contracts in Bankruptcy: Part II*, 57 MINN. L. REV. 479 (1974). A minority of courts follow the so-called "functional" approach where the question of executoriness is determined by the benefits that assumption or rejection would produce for the estate. *See* Gen. Dev. Corp. v. Atl. Gulf Cmtys Corp. (*In re* Gen. Dev. Corp.), 84 F.3d 1364, 1375 (11th Cir. 1996).

42. *See* Butner v. United States, 440 U.S. 48, 52 (1979).

43. *See infra* Part III.H.

44. *See* 11 U.S.C. § 365(b).

45. *See id.* § 365(a).

46. *See id.* § 365(f). Pursuant to 11 U.S.C. § 365(c), there are limits on the ability to assume and assign under certain circumstances, including applicable law excusing a counterparty from accepting performance and contracts to make loans or provide financial accommodations. 11 U.S.C. § 365(c).

47. *See* 11 U.S.C. § 365(g).

unsecured claim against the Debtors for breach of contract damages as a result of the rejection.[48]

G. Valuation of Property of the Estate

The issue of valuation is important in many stages of a Chapter 11 proceeding, including sales, use of estate property, post-petition financing secured by priming liens, and the evaluation of pre-petition transactions under fraudulent transfer laws. Courts value assets according to the purpose and context of the situations surrounding the valuations and have generous discretion in determining valuation metrics, including whether to value the assets at fair market value or under a liquidation value.[49] Valuation is highly situational and can be an inexact science.[50] Energy assets can be complex to value. Valuation of energy assets often comes down to a "battle of experts," and courts may favor experts that have real, concrete experience in the energy industry, even at the expense of relevant advanced accounting or financial degrees.[51] When valuing energy assets, the only true consensus among courts is that such valuation is a difficult task.[52] When valuing a complex energy enterprise, a court will generally use one or more of the four most common valuation methods: discounted cash flow, comparable companies, comparable transactions, and market approach.[53]

48. *In re* Nat'l Steel Corp., 316 B.R. 287, 304 (Bankr. N.D. Ill. 2004).

49. *See* 11 U.S.C. § 101(32) (determination of a debtor's insolvency made according to "fair valuation"); 11 U.S.C. § 506(a) (value of secured creditor's claim shall be "determined in light of the purpose of the valuation"); *In re* Heritage Highgate, Inc., 679 F.3d 132, 141 (3d Cir. 2012) ("Congress envisioned a flexible approach to valuation [under 11 U.S.C. § 506(a)] whereby bankruptcy courts would choose the standard that best fits the circumstances of a particular case."); WRT Energy Corp. v. WRT (*In re* WRT Energy Corp.), 282 B.R. 343, 368–369 (Bankr. W.D. La. 2001) ("Courts generally conduct a two-step analysis to determine whether a debtor is insolvent under the balance sheet test. First, the court determines whether it is proper to value the Debtor's assets on a 'going concern' basis or a 'liquidation' basis. Second, the court conducts a 'fair valuation' and assigns a value to all the Debtor's assets and liabilities as of the date of the challenged transfer. These assets and liabilities are tallied, and if debts exceed assets at fair valuation as of the date of the challenged transfer, the Debtor is 'insolvent' within the meaning of the balance sheet test.") (citations omitted).

50. *See In re* Sherman, 157 B.R. 987, 989 (Bankr. E.D. Tex. 1993) ("No other area is more central to the bankruptcy process yet more perplexing to those practitioners and courts presented with its permutations than the question of valuation of assets.").

51. Floyd v. Hefner, 556 F. Supp. 2d 617, 639 (S.D. Tex. 2008) ("[The expert's] lack of a formal accounting degree does not disqualify his opinions in this case given the level of his professional experience in [the oil and gas] field.").

52. *See, e.g.*, *In re* Cassetto, 475 B.R. 874, 882 (Bankr. N.D. Ohio 2012) ("The difficulty of valuing subsurface, i.e., unsevered, oil and gas rights is apparent."); *In re* Gulf Coast Oil Corp., 404 B.R. 407, 412 (Bankr. S.D. Tex. 2009) ("While all valuation is complex and uncertain, valuation of oil and gas interests is especially difficult . . . .").

53. Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1, 16 (2012) ("It is important to remember that bankruptcy judges have become familiar and comfortable with the DCF, comparable companies and comparable transactions methodologies. Indeed, these methods are often referred to as the 'standard' methodologies.") (quoting *In re* Chemtura Corp., 439 B.R. 561, 573 (Bankr. S.D.N.Y. 2010)).

1. Discounted Cash Flow

Under a discounted cash flow (DCF) analysis, a company's future cash flow is projected and then discounted by the projected weighted average cost of capital.[54] A DCF analysis is used in substantially all cases. Courts generally prefer more data than less, and, unlike its peer methods, DCF is almost always possible to use because it focuses on the company's own internal numbers and projections and is not dependent on data from competitors. The heart of a DCF valuation battle is the projection of a company's future cash flows and the appropriate discount rate. Courts realize that projections require judgment and predictions, and therefore demand that the projections be backed by realistic, concrete evidence that takes into account limitations on future growth and success as well as likely pitfalls.[55] In considering a company's projections, courts consider the past performance of a company as a barometer in which to evaluate future estimates.[56]

In the context of upstream oil and gas valuations, it is common to use reserve reports that estimate the volume and recoverability of hydrocarbons.[57] These assets may be valued according to future-looking "forward strip" pricing as determined by pricing benchmarks such as the New York Mercantile Exchange or the SEC pricing that carries forward a 12-month average price (calculated as the unweighted arithmetic average of the first day of the month price for each month within the 12-month period prior to the end of the reporting period).[58] However, a court is not bound by these metrics. Because time increases the risk of unforeseen contingencies, the further into the future the projections extend, the more cautious courts will be in the use of such projections.[59] Thus, courts may not find aggressive valuations credible, especially those that appear to "cherry-pick" certain contingencies or figures without applying the possible negative implication of these to the entirety of a report.[60]

Exploration and production (E&P) entities and their assets often present especially difficult DCF studies. The value of E&P assets is generally not

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54. *See id.* at 7.

55. *See In re* Cellular Info. Sys., Inc., 171 B.R. 926, 932 (Bankr. S.D.N.Y. 1994) (criticizing a small cell phone company's expert for static, simplified projections of the cell phone market from 1994 to 1999); *In re* M & S Assocs. Ltd., 138 B.R. 845, 851 (Bankr. W.D. Tex. 1992).

56. *See In re* Mirant Corp., 334 B.R. 800, 836 (Bankr. N.D. Tex. 2005).

57. *See* Alex W. Howard & Alan B. Harp, Jr., *Oil and Gas Company Valuations*, 28 BVR 30, 31-32 (2009) (discussing the use of reserve reports to estimate the availability and recoverability of hydrocarbons).

58. *See id.* at 32.

59. *In re Mirant*, 334 B.R. at 827–828 ("Mirant Group's underestimation of gas prices is still potentially significant [for valuation].").

60. *Id.* at 828–829 ("Further, while several experts suggested the increase in gas prices was only temporary, continued high prices strongly suggest that, as at least one service contends, they represent a long term trend and higher gas prices should therefore be factored into the valuation of Mirant Group."); *see, e.g., In re* Tribune Co., 464 B.R. 126, 151 (Bankr. D. Del. 2011) ("The Rebuttal Report sets forth proposed revisions, but does not indicate how 'cherry-picked' changes would impact the report as a whole.").

quoted in a publication, the assets tend to be unique, and the realization of value has the added risk of minerals yet to be extracted from beneath the surface. Valuation of E&P assets has several moving parts, including the reserve volume of hydrocarbons, the expense required to extract the hydrocarbons, the existence of arrangements with third parties having interests in the hydrocarbons, the likelihood of extraction, and the price of the hydrocarbons in the future. The valuation battle will often hinge on a disputed reserve report or competing reserve reports concerning the status and volume of hydrocarbons. Even with modern seismic technology, there is often reasonable disagreement over the basic question of the recoverability of minerals on any given tract, let alone other contingencies. Proven developed producing reserves are often considered the most valuable and may be discounted using a lower rate than other forms of reserves, such as (a) proved developed non-producing reserves, which must be discounted based on risk and time of production; (b) proven undeveloped reserves, which must be discounted based on the risk, time, and expense of production; and (c) unproven reserves in net acreage yet to be "shot" with seismic, which are often significantly discounted based on increased risk.[61]

An often contested aspect of a DCF analysis is choosing the discount rate to be applied to the projections. Due to the subjective nature of picking a discount rate, discount rates that appear to stray too far from the rates used by others in the case, as well as those that are not credibly explained, face the risk of being disregarded by the court.[62] The modern oil and gas industry operates in remote, difficult, and often unproven locations which can heighten the issue as to whether a discount rate, which must correlate to the probable success of a debtor's operations, is credible.[63]

61. Nancy Sue Davis Trust v. Davis Petroleum Corp. (*In re* Davis Petroleum Corp.), 385 B.R. 892, 908 (Bankr. S.D. Tex. 2008*)* (examining discount rates assigned to different levels of reserves).

62. *In re* Exide Techs., 303 B.R. 48, 64 (Bankr. D. Del. 2003) ("[The expert's] numerous subjective adjustments to the analysis stray too far from the generally accepted method of determining the discount rate. Therefore, I will rely on [the other expert's] more straight forward determination of the discount rate.").

63. *In re Davis*, 385 B.R. at 908 ("Drilling wells in the Gulf of Mexico is not a 'low risk' business. Further, drilling the first well is not always a good indicator as to future economic value because it requires sometimes three, four, or five to determine that the reserves are sufficient to cover the cost of production.").

2. Comparable Company

The comparable company valuation method derives a debtor's value from the relative value of its peers.[64] This is a two-part process. First, earnings before interest, taxes, depreciation, and amortization (EBITDA) of the Debtor is calculated.[65] Next, multiples of EBITDA based on the EBITDA multiples of comparable companies are calculated, analyzed, and used to select an EBITDA multiple to apply to the Debtor's EBITDA to determine the Debtor's value.[66] Application of the comparable company analysis can be a challenge, and a comparable company selected to value an E&P debtor may not be considered a true comparable, even given some fundamental similarities, if there are still material differences of risk exposure such as countries operated in or the competitor's presence in a different industry or sub-industry.[67]

3. Comparable Transactions

The comparable transaction analysis identifies a recent transaction of similarly situated assets or enterprise and then scales the price according to the Debtor's assets/enterprise value.[68] Though more information is generally always better in valuations, courts will sometimes forego a comparable transactions analysis if it is simply not practical.[69] If using this method, a court may prefer that the transaction involve a near-identical match of the Debtor, which, as discussed above in the comparable companies section, is no easy task.[70] The transaction itself should be recent or at least within similar market conditions[71] (especially in the oil and gas industry given the movement of commodity prices), and the details of the transaction should be straightforward and accessible.[72]

4. Market-Based Approach

The market-based approach examines the value the market assigns to a

64. *See In re Exide*, 303 B.R. at 61.

65. Kenny O'Rourke, *Valuation Uncertainty In Chapter 11 Reorganizations*, 2005 COLUM. BUS. L. REV. 403, 420 (2005).

66. *Id.*

67. *See In re* Mirant Corp., 334 B.R. 800, 837 (Bankr. N.D. Tex. 2005) ("The court also has some concern about the use of Dynegy [as a comparison to Debtor], given its liquefied natural gas business."); *id*. ("The countries in which [a competitor] operates are different—and, in many cases, arguably less prone to instability—than those in which [the Debtor] has a presence.").

68. *See* Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judges View*, 20 AM. BANKR. INST. L. REV. 1, 12–13 (2012).

69. *See In re Mirant*, 334 B.R. at 816.

70. *See* U.S. Bank Nat'l Ass'n v. Wilmington Trust Co. (*In re* Spansion, Inc.), 426 B.R. 114, 135 (Bankr. D. Del. 2010).

71. *In re* Exide Techs., 303 B.R. 48, 62–63 (Bankr. D. Del. 2003) (rejecting transactions in industry where market changed considerably from 1998 to 2002).

72. *See In re* Chemtura Corp., 439 B.R. 561, 585–586 (Bankr. S.D.N.Y. 2010) (noting that the transaction does not need to be closed to be considered under analysis if sufficient documentation is available); *In re* Cellular Info. Sys., Inc., 171 B.R. 926, 936 (Bankr. S.D.N.Y. 1994) (rejecting a sale where sale terms were too contingent and complicated to discern an actual value paid).

debtor, often by using market evidence to ascertain the total capital value of the Debtor.[73] This can be achieved by using the market price assigned to the securities in the Debtor's capital structure by the stock or bond markets.[74] The Third Circuit has stated "[a]bsent some reason to distrust it, the market price is a more reliable measure of . . . value than the subjective estimates of . . . expert witnesses,"[75] and the United States Supreme Court has also expressed its view that market evidence should be used in bankruptcy proceedings when possible.[76] However, a court may be reluctant to only use the market value because of (1) the "taint" of bankruptcy on an asset's price due to third parties not giving the Chapter 11 process enough credit,[77] (2) the cloudiness a bankruptcy case may create in valuing an already complex asset,[78] or (3) fraud or concealment of material information to the market.[79]

An example of a market-based valuation application in bankruptcy (commonly used in fraudulent transfer disputes) is the valuation of Idearc, a "yellow pages" business.[80] Verizon divested its "yellow pages" business and assets to a new separate entity, Idearc.[81] As a result of the transaction, Idearc was left with approximately $9 billion in debt.[82] Idearc performed "reasonably well"[83] for about a year but, after struggling, commenced Chapter 11 proceedings. The trustee of Idearc sued Verizon for, among other claims, fraudulent transfers based on the value it received from Idearc's spin-off.[84] As the court recognized in a preliminary opinion, the dispositive inquiry was whether the spun-off Idearc was insolvent at creation, and if so, as creditors of a financially stillborn entity, whether Idearc's creditors would have been defrauded.[85] Thus, the parties presented substantial and complex evidence in

73. *See* VFB LLC v. Campbell Soup Co., 482 F.3d 624, 633 (3d Cir. 2007).

74. Fairly conducted sales can also be evidence of a market valuation trumping an expert valuation. *See In re* Bos. Generating, LLC, 440 B.R. 302, 325–328 (Bankr. S.D.N.Y. 2010) (finding that the sale of power assets indicated the value of assets, even with conflicting DCF analysis).

75. *VFB*, 482 F.3d. at 633 (3d Cir. 2007) (internal quotation marks omitted).

76. *See* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. Lasalle St. P'ship, 526 U.S. 434, 457–58 (1999).

77. *See In re* Mirant Corp., 334 B.R. 800, 835 (Bankr. N.D. Tex. 2005) (citing *In re* Exide Techs., 303 B.R. 48, 66 (Bankr. D. Del. 2003).

78. *In re Mirant*, 334 B.R. at 834.

79. *See* Tronox Inc., v. Kerr McGee Corp. (*In re* Tronox Inc.), 503 B.R. 239, 298–303 (Bankr. S.D.N.Y. 2013) (indicating that market valuation was not indicative where court found the information was obscured); Kerry O'Rourke, *Valuation Uncertainty in Chapter 11 Reorganizations*, 2005 COLUM. BUS. L. REV. 403, 417–18 (2005) (discussing Adelphia Communications bankruptcy where thin market existed for such a complex company); *id.* at 416 (explaining that potential buyers are often connected to the case, and thus privy to confidential information and restricted by the government).

80. The defendants in the Verizon case characterized the spun off entity as a "cash cow." U.S. Bank Nat'l Ass'n. v. Verizon Commc'ns. Inc., 892 F. Supp. 2d 805, 808 (N.D. Tex. 2012).

81. *Id.* at 810.

82. Verizon received $2.4 billion in cash from Idearc, and exchanged with J.P. Morgan and Bear Stearns $7.08 billion of its own debt for $7.15 billion of Idearc debt. *Verizon*, 892 F. Supp. 2d at 809–810.

83. *Id.* at 810.

84. *Id.*

85. *Id.* at 813.

an attempt to prove the value of Idearc.[86] The court heavily relied upon a relatively straightforward valuation metric: the equity value of Idearc as indicated by the valuation placed on Idearc's equity by the public stock market.[87]

The trustee's expert in the case used the three standard valuation methods ubiquitous to valuation disputes: the DCF method, the comparative multiples method of similar companies, and the comparable transaction method. Two of these methods (the DCF and comparable transaction methods) resulted in an asset valuation substantially lower than the approximately $9 billion Idearc needed to be considered solvent, with the comparative multiples method producing a solvent value.[88] The trustee's expert then blended these amounts allocated to certain percentages to come up with a value of approximately $8.15 billion for Idearc, which would have made Idearc insolvent when founded.[89] However, the trustee did not consider the trading price of Idearc's common stock on the day of the spinoff.[90] The trustee excluded this data point because he alleged the price was inflated due to the withholding of information and potential fraudulent representations made by Verizon at the time of the transaction.[91]

The court put the onus on the trustee to demonstrate why the market did not value Idearc correctly, that is, to prove some kind of material fraud or concealment by Verizon in undertaking the spin-off.[92] The trustee did not convince the court that promotions by Verizon were materially fraudulent, that critical dissent by some Verizon insiders was indicative of wide-scale fraud, or that inherent risks associated with this particular company (most notably the risk of alternative internet sources destroying Idearc's business in a "secular" shift)[93] were hidden from the public. Instead of being defrauded in setting its market price, investors simply made a bad bet on the company.[94] The decision appears to be among a growing trend of courts in requiring heavier scrutiny of a party attempting to meet a valuation burden that differs from the valuation derived by an active and discernible market.[95]

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86. *Id.* at 813–14.

87. U.S. Bank Nat'l Ass'n v. Verizon Commc'ns., Inc., No. 3:10-CV-1842-G, 2013 WL 230329, at *9 (N.D. Tex. Jan. 22, 2013).

88. *Id*. at *10–11.

89. *Id.*

90. *Id.*

91. *Id*. at *19.

92. *Id.* at *23–24.

93. *Id.* at *23–25 ("The evidence demonstrated that investors were aware that [the yellow pages business] was undergoing a secular change.").

94. *Id.* at *17. Particularly compelling to the court was the testimony of Idearc's former C.E.O., privy to all relevant information, who testified that she would not have agreed to lead the company if she had believed that the equity markets, in assigning a robust solvent valuation of Idearc, were flawed. *Id.*

95. *See, e.g.*, VFB LLC v. Campbell Soup Co., 482 F.3d 624, 632–33 (3d Cir. 2007) ("Absent some reason to distrust it, the market price is a more reliable measure of . . . value than the subjective estimates of . . . expert witnesses.") (internal quotation marks omitted).

H. Avoidance Actions

The Bankruptcy Code enables, in certain circumstances, the trustee to avoid transfers made or obligations incurred by a debtor prior to bankruptcy. Actions to avoid transfers or obligations are sometimes referred to as "claw-backs" and primarily take the form of adversary proceedings to avoid and recover preferential and fraudulent transfers.[96]

Bankruptcy Code § 547 permits the trustee to avoid as preferences transfers of an interest of the Debtor in property made on account of an antecedent debt when the Debtor was insolvent, within ninety days of a bankruptcy filing[97] (or, in the case of a transfer to an insider,[98] within one year before the bankruptcy filing),[99] that enabled the creditor to receive more than the creditor would receive if the case were a case under Chapter 7, the transfer had not been made, and the creditor received payment under the distribution provisions of the Bankruptcy Code.[100] Preferences are equitable actions to prevent the Debtor from "preferring" by payment one creditor in the short run before bankruptcy.[101] The Bankruptcy Code provides several affirmative defenses to a preference action such as the defense that there was a contemporaneous exchange for new value[102] to the estate,[103] or that the transfer was made in the ordinary course[104] of business or financial affairs of the Debtor and the transferee or was made according to ordinary business terms.[105]

Fraudulent transfer actions may be brought under substantive state statutes through Bankruptcy Code § 544[106] and may also be brought under Bankruptcy Code § 548[107] to seek the avoidance of a transfer of property or an obligation incurred. The trustee may avoid under Bankruptcy Code § 548 any transfer of an interest of the Debtor in property or any obligation incurred by the Debtor

96. Avoidance risk is a factor that is often evaluated in out of court restructurings.

97. 11 U.S.C. § 547(b)(4)(A) (2012).

98. The definition of "insider" includes many examples, such as a relative of an individual debtor or director of a corporate debtor, but is not limited to the statutory examples. *See* 11 U.S.C. § 101(31).

99. 11 U.S.C. § 547(b)(4)(B).

100. *Id.* § 547(b).

101. Hechinger Inv. Co. of Del., Inc. v. M.G.H. Home Improvement, Inc. (*In re* Hechinger Inv. Co. of Del.), 288 B.R. 398, 402 (Bankr. D. Del. 2003); *see* Union Bank v. Wolas, 502 U.S. 151, 161 (1991) (noting that the more important consideration in permitting avoidance of pre-bankruptcy transfers is equality of distribution among creditors).

102. 11 U.S.C. § 547(a)(2).

103. *Id.* § 547(c)(1).

104. Gasmark Ltd. Liquidating Trust v. Louis Dreyfus Natural Gas Corp., 158 F.3d 312 (5th Cir. 1998) ("There is no precise legal test for whether payments are in the ordinary course of business. Rather, the analysis focuses on the time within which the Debtor ordinarily paid the creditor . . . and whether the timing of the payments during the 90-day period reflected some consistency with that practice.") (citation omitted) (internal quotation marks omitted).

105. 11 U.S.C. § 547(c)(2).

106. Bankruptcy Code § 544 allows an estate to utilize state law fraudulent transfer statutes. 11 U.S.C. § 548. Every state allows the recovery of fraudulent transfers, and, often, courts will view precedent interchangeably for Bankruptcy Code § 548 and state law fraudulent transfer suits. *See, e.g.*, Kojima v. Grandote Int'l. LLC (*In re* Grandote Country Club Co. Ltd.), 252 F.3d 1146, 1152 (10th Cir. 2001).

107. 11 U.S.C. § 548(a).

on or within two years before the date of the filing of the petition if the Debtor made the transfer with the intent to hinder, delay, or defraud a creditor (actual fraud) or if the Debtor was insolvent, had unreasonably small capital, reasonably believed it could not pay its debts, was made insolvent, or made the transfer to an insider under an employment contract not in the ordinary course of business (constructive fraud).[108]

A defendant may, however, defend against such action if it both gave value to the estate and also acted in good faith under the affirmative defense available under Bankruptcy Code § 548(c),[109] but the defendant bears the burden of proof on both issues.[110] The trustee, in addition to fighting against the good faith and value defense, must overcome special statutory defenses granted to defendants that protect, among other transactions, swap and commodity contracts from actual fraudulent transfers.[111]

In bankruptcy cases in the oil and gas industry, fraudulent transfer actions may seek to undo transactions that were disadvantageous to the Debtor.[112] Fraudulent transfer claims may challenge whole transfers of oil and gas assets, leading to valuation proceedings over how much value the estate received in exchange for the assets or the motivations of the Debtor in undertaking the transaction.[113] Two prominent examples of this include *In re Tronox*, where a court found that a debtor saddled an entity with environmental liabilities with an intent to hinder, delay, or defraud creditors through a spinoff,[114] and *In re Asarco*, where a court found that the Debtor hindered and delayed creditors by directing all consideration received from a sale of a majority of a mining entity to one of the Debtor's creditors to the detriment of other creditors.[115]

Under Bankruptcy Code § 549, the trustee may also avoid a transfer of property of the estate that occurs after the commencement of the case that (a) is authorized only under Bankruptcy Code § 303(f) (relating to involuntary

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108. *Id.*

109. *Id.* § 548(c).

110. Marathon Petroleum Co., LLC v. Cohen (*In re* Delco Oil, Inc.), 599 F.3d 1255, 1258 (11th Cir. 2010). This is a narrow defense. *Marathon Petroleum*, 599 at 1263 ("Sections 549(a) and 550(a) by their terms contain no reference to, let alone an actual defense based on, the transferee's status (vendor, purchaser, etc.) or upon its state of mind (innocent, culpable, etc.).").

111. *See supra* Part II.A.

112. *See* Hutson v. U.S. Dep't of the Army (*In re* Nat'l Gas Distribs., LLC), 415 B.R. 209, 214 (Bankr. E.D.N.C. 2009).

113. *See* Calpine Corp. v. Rosetta Res., Inc. (*In re* Calpine Corp.), 377 B.R. 808, 810–811 (Bankr. S.D.N.Y. 2007) ("According to the complaint [seeking to undo the transaction as a constructive fraudulent transfer], prior to the petition date, . . . Calpine entered into a purchase and sale agreement to sell substantially all of its remaining domestic oil and gas assets (other than certain gas pipeline assets) . . . for $1.05 billion to a group led by Calpine insiders, the management team of its subsidiary, Rosetta. The buyers funded the purchase price through debt and a private placement offering of equity in which they themselves participated. The bulk of the assets consisted of in-ground unextracted hydrocarbons not facilely estimated by either bankers or non-insider hydrocarbon experts.").

114. Tronox Inc. v. Kerr McGee Corp. (*In re* Tronox Inc.), 503 B.R. 239, 280 (Bankr. S.D.N.Y. 2013).

115. Asarco LLC v. Ams. Mining Corp. (*In re* Asarco LLC), 396 B.R. 278, 386–88 (S.D. Tex. 2008).

cases)[116] or § 542(c) (relating to certain transfers by third parties to entities other than the trustee) or, under a more expansive subsection, (b) is not authorized under the Bankruptcy Code or by the court.[117] For instance, under 11 U.S.C. § 549, the Eleventh Circuit upheld the avoidance of post-petition payments from an energy debtor for petroleum products made with another creditor's cash collateral in *In re Delco Oil, Inc.* as the Debtor used the cash collateral without the secured creditor's consent or the court's authorization.[118]

I. Derivatives and Financial Contracts in Energy Reorganization

Derivatives play increasingly important roles in the energy industry via commodities contracts, forward contracts, swaps, and other similar agreements. The Bankruptcy Code excepts certain types of energy related derivatives contracts from the automatic stay and avoidance actions, including the derivative and swap markets, through Bankruptcy Code §§ 362(b),[119] 546(e),[120] 548(d)(2),[121] 555,[122] 556,[123] and 560.[124] These sections allow parties to net out, liquidate, terminate, accelerate, or set off debts under certain energy-related derivative contracts after the commencement of a bankruptcy case and protect counterparties of these contracts from avoidance actions in relation to pre-petition payments or transfers.[125]

Oil and gas derivatives are contracts where parties can hedge the price of oil and gas to help smooth the impact of price volatility on operations. Derivatives are traded through public exchanges and also "over the counter" via private transactions. Derivatives traded over exchanges are regulated by the exchange, which requires parties to post collateral to cover trades.[126] Because the derivatives are often traded over a market exchange, the contracting parties will

116. In an involuntary case, the trustee may not avoid, according to Bankruptcy Code § 549(b), "a transfer made after the commencement of [the] case but before the order for relief to the extent any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given after the commencement of the case in exchange for such transfer." 11 U.S.C. § 549(b) (2012).

117. 11 U.S.C. § 549(a).

118. Marathon Petroleum Co. v. Cohen (*In re* Delco Oil, Inc.), 599 F.3d 1255, 1263 (11th Cir. 2010).

119. Exception from the automatic stay.

120. Exception from fraudulent transfers. Bankruptcy Code § 546(e) faces the potential of being limited if a holding from the Southern District of New York that ruled that individual creditors bringing State law constructive fraudulent transfer actions were not preempted by Bankruptcy Code § 546(e) from bringing these lawsuits as Bankruptcy Code § 546(e) only applies to trustees in bankruptcy is upheld and followed. *In re* Tribune Co. Fraudulent Conveyance Litig., 499 B.R. 310, 317–319 (S.D.N.Y. 2013). Still, this decision did deny individual creditors standing due to the fact that they were bringing concurrent, duplicative lawsuits alongside the trustee's own. *Id.* at 320–21.

121. Exception from fraudulent transfers.

122. Contractual right to liquidate, terminate, or accelerate a securities contract.

123. Contractual right to liquidate, terminate, or accelerate a forward contract.

124. Contractual right to liquidate, terminate, or accelerate a swap agreement.

125. For a further analysis of these provisions, see another Vinson & Elkins paper on the topic written by Harry Perrin and John West. Harry Perrin & John West, "Derivatives and the Bankruptcy Code," American College of Bankruptcy Seminar, April 28, 2009, San Antonio, Texas.

126. MICHAEL DURBIN, ALL ABOUT DERIVATIVES 6–7 (2nd ed. 2010).

not directly interact with each other and may not even know each other's identities. "Over the counter" derivatives are economically similar to exchange traded derivatives but arise through a private business relationship. These over-the-counter contracts enable a party to customize terms; however, they do not have exchange rules that may protect one party against the credit risk and insolvency of the other party.[127]

Derivatives contracts, due to their risks, often contain negotiated protections for the parties. Among potential derivative protective provisions are clauses granting parties the right to "net-out" or "setoff" obligations under multiple contracts so as to enable the counterparty to withhold payments to the Debtor due to other debts owed between the parties.[128] Other provisions allow parties to accelerate or demand payment early, liquidate contracts, or foreclose on collateral or other assets in the event of the other party's non-payment or pending insolvency. The courts have construed the Bankruptcy Code's safe harbor provisions to be quite broad in encompassing many transactions that are meant as a hedge or as speculation in the oil and gas markets.[129] Thus, while covered derivative contracts are classified under different types of definitions under the Bankruptcy Code, such as forward contracts, swap agreements, and commodity contracts, and payments are classified as settlement payments or margin payments, the essential test for whether these contracts or payments are exempt from otherwise applicable bankruptcy provisions is whether the underlying contracts are used by a party for hedging or speculating, at least in part.[130]

Courts have held that derivative contracts are protected under the statutory safe harbors as long as hedging was intended, no matter whether the party could possibly receive or actually anticipate receiving the commodities.[131] However, some case law strictly construes the requirements for a party to fall under a safe harbor, including *In re Mirant*, which holds that a contracting party could not qualify for protected status as a forward contract merchant in a forward contract when it "is not acting as either an end-user or a producer," but

127. *Id.*

128. Rhett G. Campbell, *Energy Future and Forward Contracts, Safe Harbors and the Bankruptcy Code*, 78 AM. BANKR. L.J. 1, 23–25 (2004).

129. Oil and gas are considered commodities and their trading related agreements typically qualify as forward contracts, commodities contracts, swap agreements, and the like. *See* Williams v. Morgan Stanley Capital Grp. (*In re* Olympic Natural Gas Co.), 294 F.3d 737 (5th Cir. 2002); U.S. Bank Nat'l Ass'n v. Plains Mktg. Can. LP (*In re* Renew Energy LLC), 463 B.R. 475, 479 (Bankr. W.D. Wis. 2011).

130. *See* Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352, 356–357 (5th Cir. 2012). Hutson v. E.I. du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 257–258 (4th Cir. 2009).

131. BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating Ltd. P'ship), 336 B.R. 214, 225 (Bankr. D. Del. 2006) (citing 5 COLLIER ON BANKRUPTCY § 556.03[2] at 556–6 (15th ed. Rev. 2001)); Williams v. Morgan Stanley Capital Grp. (*In re* Olympic Natural Gas Co.), 258 B.R. 161, 164–166 (Bankr. S.D. Tex. 2001) ("Forward contracts provide the ability to buy or sell commodities in the market on a forward basis. . . . [and]. . . . Courts . . . have consistently construed the term settlement payment broadly.") (internal quotation marks omitted).

rather should be one that "buys, sells or trades in a market."[132] The *Mirant* definition limits the safe harbor to speculators and traders and not to parties that intend to actually use the hydrocarbons, even if they use the derivatives for price stability.[133]

Congress amended the Bankruptcy Code after *Mirant* to add swap agreements to the safe harbor, which at least one court views as expanding the safe-harbor provisions.[134] Thus, it may be argued that Congress intends that the safe harbor apply to parties involved in these swap agreements,[135] whether the contracts derive from a trading exchange or contemplate actual delivery of the commodity.[136] Specifically, the Fourth Circuit held that, "Congress has provided safe harbors from the destabilizing effects of bankruptcy proceedings for parties to specified commodities and financial contracts in order to protect financial markets."[137] Whether a contract is a swap agreement, a forward contract, or both, parties have the same protections under the Bankruptcy Code.

Some of the safe-harbor provisions require specific language in contracts in order for a party to benefit from the Bankruptcy Code's protections. For example, in order for a party to be able to net out, accelerate, or liquidate an agreement without violating the automatic stay,[138] the contract must specifically give the party this right upon the insolvency (or likely insolvency or bankruptcy filing) of the Debtor through an "*ipso facto*" provision.[139]

Many protections that enable parties to avoid bankruptcy impediments under the automatic stay, such as those available under Bankruptcy Code §§ 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), and 362(o) under commodity contracts, forward contracts, repurchase agreements, swap agreements, and master netting agreements, do not require *ipso facto* provisions, but still require "contractual rights" between the parties.[140] Under the Bankruptcy Code, "contractual rights" do not actually need to be included in a contract to be valid. Instead, parties can possess them by virtue of rules and regulations governing a trading exchange or simply because the rights are standard under

132. Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 567 (Bankr. N.D. Tex. 2004).

133. *See id.*

134. *In re Nat'l Gas Distribs.*, 556 F.3d at 253–54; *see also* Eleanor Heard Gilbane, *Testing the Bankruptcy Code Safe Harbors In The Current Financial Crisis*, 18 AM. BANKR. INST. L. REV. 241, 251 (2010) (Congress intended to encompass "every conceivable type of swap transaction including customized transactions").

135. *In re Nat'l Gas Distribs.*, 556 F.3d 247 at 253–54.

136. *See id.* at 255–57.

137. *Id.* at 252.

138. Additionally, the Bankruptcy Code contains a section that mandates that damages for a rejected derivatives contract will be measured not by the date of the petition, but by the earlier date of the actual rejection or the liquidating, terminating, or accelerating of the contact by the counter party. *See* 11 U.S.C. § 562 (2012).

139. *See In re* Clearwater Natural Res., LP, No. 09-70011, 2009 WL 2208463, at *3 (Bankr. E.D. Ky. July 23, 2009) (noting that a contract lacking a 365(e)(1) provision giving rise to a right to terminate "cannot not be terminated without court approval").

140. *In re* Lehman Bros. Holdings, Inc., 433 B.R. 101, 113 (Bankr. S.D.N.Y. 2010), *aff'd sub nom. In re* Lehman Bros. Holdings Inc., 445 B.R. 130 (S.D.N.Y. 2011).

normal business practice.[141]

Some courts have found that a party waived termination rights through inaction. For instance, in the *Lehman Bros.* bankruptcy, a derivative party with contractual rights to terminate a contract upon bankruptcy did not promptly execute its contractual rights.[142] When the counterparty eventually tried to liquidate the contract, the court refused to allow this termination, finding that the party had waived its rights and ordering that the party continue to act under the contract's terms until rejection of the contract.[143]

J. Regulatory Matters

Regulatory authorities are important parties in energy restructurings and reorganizations. Certain local, state, and national bodies regulate the energy industry, and include the Environmental Protection Agency (EPA), the Department of Interior (DOI),[144] the Federal Energy Regulatory Commission (FERC),[145] and various state environmental and energy focused agencies. Governmental units acting in their regulatory or police capacity are permitted to exercise their police power to regulate a debtor's estate despite the automatic stay, pursuant to an exception set forth in Bankruptcy Code § 362(b)(4).[146] Governmental units are often creditors in oil and gas bankruptcies,[147] but governmental units may not use this exception to the automatic stay unless they are acting under a true regulatory or police function.[148] Courts address these issues case by case with a fact-intensive analysis, but, generally, a governmental unit must be seeking to remedy some kind of harm instead of merely seeking to better the government's financial position.[149]

Notably, there does not need to be any "imminent and identifiable harm" present for a government action to qualify under the Bankruptcy Code § 362(b)(4) exception to the automatic stay.[150] All that is necessary is that a

141. 11 U.S.C. §§ 555–56, 559–561.

142. *See* Order to Compel Performance of Contract and to Enforce the Automatic Stay, *In re* Lehman Brothers Holding Inc., No. 08-13555 (S.D.N.Y. Sept. 17, 2009), ECF No. 5209.

143. *Id.*

144. Within the Department of Interior, the Bureau of Ocean and Energy Management and the Bureau of Safety and Environmental Management regulate offshore properties.

145. *See infra* Part VII.C.

146. 11 U.S.C. § 362(b)(4).

147. For instance, the federal government is a creditor for royalty payments on the Outer Continental Shelf. *See* 43 USC § 1337 (2012).

148. Berg v. Good Samaritan Hosp., Inc. (*In re* Berg), 230 F.3d 1165, 1167 (9th Cir. 2000).

149. *Id.*; Penn Terra, Ltd. v. Dep't of Envtl. Res., Commonwealth of Pa., 733 F.2d 267, 278 (3d Cir. 1984).

150. Commonwealth Cos., Inc. v. Commonwealth Cos., Inc. (*In re* Commonwealth Cos., Inc.), 913 F.2d 518, 522 (8th Cir. 1990); Commonwealth Oil Ref. Co. v. United States Env't Prot. Agency (*In re* Commonwealth Oil Ref. Co., Inc.), 805 F.2d 1175, 1182 (5th Cir. 1986); Emerald Casino, Inc. v. Ill. Gaming Bd. (*In re* Emerald Casino, Inc.), No. 05 C 6625, 2006 WL 644487 (N.D. Ill. Mar. 8, 2006), *aff'd sub nom.* Vill. of Rosemont v. Jaffe, 482 F.3d 926 (7th Cir. 2007). There are cases that hold that

governmental unit be acting to enforce a regulatory or compliance law meant to set standards and guidelines for private actors in order to protect the public.[151] For example, in *Matter of Commonwealth Oil Refining Co.*, the EPA sought to force a debtor to cease refining activities unless it came into compliance with applicable federal environmental laws requiring strict parameters of the storing of hazardous waste.[152] The court declined to rule on the merits of the environmental laws or the EPA's claim in deciding whether Bankruptcy Code § 362(b)(4) applied, but instead found that as long as the EPA was seeking to enforce compliance with environmental or regulatory statutes, it was not barred by the automatic stay.[153]

Additionally, though the automatic stay of Bankruptcy Code § 362 does not prohibit governmental units from seeking judgments against a debtor to further a regulatory goal, they may not collect such judgments free of court approval.[154] Thus, there is an "exception to the exception," with courts not allowing money to be taken from the estate free of judicial control, though injunctions may be entered.[155]

K. Plans of Reorganization

In a Chapter 11 reorganization, the plan will set forth the details of how the Debtor intends to reorganize and treat its creditors. Although the Debtor may file a plan at any point in a Chapter 11 case, the Debtor has the exclusive right to file a plan only during the first 120 days after the petition date.[156] If the Debtor does not file its plan within the 120-day exclusivity period or does not file a plan that is accepted before 180 days after the petition date, any party in interest may file a plan.[157] The 120-day and 180-day exclusivity periods may be reduced or extended for cause after notice and a hearing by the court upon request by a party in interest before the expiration of the period.[158]

For the purpose of determining the treatment of the creditors, each claim or interest is placed into a class, such as tax, secured debt, unsecured, or equity interests.[159] The plan may place more than one claim or interest into a class only if such claims or interests are substantially similar.[160]

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imminent harm is needed, but they have been "roundly criticized" and are dated. *See* Cal. *ex rel*. Brown v. Villalobos, 453 B.R. 404, 411 (D. Nev. 2011), (criticizing *In re* Four Winds Enters., Inc., 87 B.R. 624, 630 (Bankr. S.D. Cal. 1988)).

151. *See City & Cnty. of S.F. v. PG & E Corp.*, 433 F.3d 1115, 1123–24 (9th Cir. 2006) (applying the "pecuniary purpose" test and the "public policy" test to determine whether an action is within a governmental unit's regulatory power).

152. *In re* Commonwealth Oil Ref. Co., Inc., 805 F.2d at 1179–1180.

153. *Id.* at 1184.

154. SEC v. Brennan, 230 F.3d 65, 71–72 (2d Cir. 2000).

155. *Id*. at 71–73.

156. 11 U.S.C. § 1121(a)–(b).

157. *Id.* § 1121(c)(2)–(3).

158. *Id.* § 1121(d)(1).

159. *Id.* § 1123(a)(1).

160. *Id.* § 1122(a).

The Bankruptcy Code sets forth certain plan provisions which are mandatory.[161] The plan must designate classes of claims.[162] Classification is not required for priority claims since their treatment is statutorily provided.[163] The plan must also classify classes of equity interests.[164] The plan must specify any class of claims or equity interests that is not impaired under the plan and delineate the treatment of any class of claims impaired[165] under the plan.[166] It must provide for the same treatment to each claim or interest in a particular class unless the claim or interest consents to less favorable treatment.[167] The plan must provide adequate means for the plan's implementation.[168] In the energy industry, adequate means for implementation of a plan can include any number of types of transactions contemplated on the plan's effective date such as a synthetic plan sale, discussed in more detail below, whereby the Debtor issues securities to the purchaser of the reorganized entity established with assets sought by the purchaser.

Before acceptance of a plan may be solicited by the plan proponent, the plan must be transmitted to each holder of a claim or equity interest entitled to vote, along with a written disclosure statement approved by the court as containing adequate information.[169] A class of claims or equity interests will have voted to accept a plan if the plan is accepted by its members that hold at least two-thirds in amount and more than one-half in number of the allowed claims of that class that actually vote.[170] A class of equity interests must vote in favor of the plan by at least two-thirds in amount of the allowed interests for that class to accept the plan.[171] A class that is not impaired under the plan is presumed to have accepted the plan, and solicitation of acceptances to an unimpaired class is not required.[172]

After notice and a hearing, the court will hold a hearing on confirmation of the plan.[173] Requirements that need to be met for confirmation of a plan include:[174]

a) the plan and the plan proponent each complies with the applicable provisions of the Bankruptcy Code;

161. *Id.* § 1123(a).
162. *Id.* § 1123(a)(1).
163. *Id.*
164. *Id.*
165. Generally, classes are impaired if their rights are left unaltered or they are fully paid subject to some exceptions. *Id.* § 1124(a)–(b).
166. *Id.* § 1123(a)(3).
167. *Id.* § 1123(a)(4).
168. *Id.* § 1123(a)(5).
169. *Id.* § 1125(b).
170. *Id.* § 1126(c).
171. *Id.* § 1126(d).
172. *Id.* § 1126(f).
173. *Id.* § 1128.
174. *Id.* § 1129.

b) the plan has been proposed in good faith and not by any means forbidden by law;

c) any payment made or to be made by the proponent, by the Debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable;

d) the proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve after confirmation of the plan as a director, officer, or voting trustee of the Debtor, an affiliate of the Debtor participating in a joint plan with the Debtor, or a successor to the Debtor under the plan and the appointment to, or continuance in, such office of such individual is consistent with the interests of creditors and equity security holders and with public policy;

e) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor and the nature of any compensation for such insider;

f) any governmental regulatory commission with jurisdiction after confirmation of the plan over the rates of the Debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval;

g) with respect to each impaired class of claims or interests: (a) each holder of a claim or interest of such class has accepted the plan or will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the Debtor were liquidated under chapter 7 of the Bankruptcy Code on such date; or (b) if Bankruptcy Code § 1111(b)(2) applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate’s interest in the property that secures such claims;

h) with respect to each class of claims or interests, such class has accepted the plan or such class is not impaired under the plan;

i) certain treatment requirements for administrative and priority claims are satisfied;

j) if a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider;

k) confirmation of the plan is not likely to be followed by the liquidation or the need for further financial reorganization of the Debtor or any successor to the Debtor under the plan unless such liquidation or reorganization is proposed in the plan;

l) all bankruptcy fees payable under section 1930 of Title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan;

m) the plan provides for the continuation after its effective date of payment of all retiree benefits (as defined in Bankruptcy Code § 1114) at the level established pursuant to Bankruptcy Code § 1114 (e)(1)(B) or (g) at any time prior to confirmation of the plan and for the duration of the period the Debtor has obligated itself to provide such benefits; and

n) all transfers of property under the plan must be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.

These requirements must be met for confirmation of a plan for any energy reorganization through the Chapter 11 process.[175]

III. UPSTREAM[176]

Upstream companies in the energy industry generally explore for and produce oil and natural gas.[177] Typically, a landowner or mineral interest owner will execute an oil and gas lease, which creates a royalty interest.[178] This royalty interest entitles the holder to a percentage of production from the lease that is free from the costs of production, and often the upstream company will pay the landowner a "bonus" payment (generally calculated on a per acre basis) at the time the lease is signed.[179] The upstream company, in turn,

175. *Id.* § 1129.

176. *See infra* Appendix A, for a depiction of the upstream players and general structure.

177. *See In re* Methyl Tertiary Butyl Ether Prods. Liab. Litig., 959 F. Supp. 2d 476, 480 (S.D.N.Y. 2013).

178. 3 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL AND GAS LAW, § 641 (2013).

179. *Id.* at §§ 301, 645.

receives a working interest so long as the lease exists.[180] This working interest is the right to drill on the premises and retain the hydrocarbons, but it is a cost-bearing interest.[181] There can be multiple working interest owners and multiple royalty interest owners, and a royalty interest can also be carved out of the working interest to create an interest such as an overriding royalty, a net profits interest, or a production payment.

The working interest owners have legal relationships as they develop the lease, including contractual (such as entering into a JOA), regulatory (such as pooling via state law), or common law relationships (when no JOA or pooling is in effect such as tenancy in common). Upon the filing for bankruptcy by an upstream company, these legal and contractual relationships are impacted and adjusted through the reorganization process.

A. Nature of Property Interest in Oil and Gas Leases and Applicability of Bankruptcy Code § 365

In the energy industry, oil and gas leases are often the Debtor's most valuable assets. An oil and gas lease is generally a grant of the right to explore, extract, sell, or own the minerals with respect to a tract of land or strata of the subsurface for a period of time and so long thereafter as oil and gas are produced.[182] Notwithstanding that the agreement may be called a lease, the agreement may not constitute an "unexpired lease" within the meaning of Bankruptcy Code § 365.[183] In Texas, an oil and gas lease creates a fee simple determinable, which is a real property interest.[184] As a real property interest rather than a true leasehold interest, an oil and gas lease in Texas is not subject to Bankruptcy Code § 365.[185] In Oklahoma, an oil and gas lease creates an incorporeal hereditament or a "profit à prendre," which is a real property interest that is also not subject to Bankruptcy Code § 365.[186] In Kansas,

180. *See Accounting and Rate Treatment of Advance Payments to Suppliers for Exploration and Lease Acquisition of Gas Producing Properties*, Order No. 441, 46 F.P.C. 1178, 1180 (1971) (defining working interest as "embodying operating rights and/or the right to share in production or revenues from the producing venture, so that its receipt of production or revenues will increase as the production or revenues from the producing venture increase, without any termination of such right to receive production or revenues after the return of the amount of any related advance payment").

181. *See* H.G. Sledge, Inc. v. Prospective Inv. & Trading Co., 36 S.W.3d 597, 599 n.3 (Tex. App. 2000) ("A working interest is an operating interest under an oil and gas lease that provides its owner with the exclusive right to drill, produce, and exploit the minerals."); Wood v. TXO Prod. Corp., 854 P.2d 880, 888 (Okla. 1992) (noting a working interest is risk-bearing subject to costs of production).

182. *See infra* Appendix B, for a fifty-state survey on oil and gas leases as executory contracts or unexpired leases.

183. *See* 11 U.S.C. § 365 (2012).

184. Terry Oilfield Supply Co., v. Am. Sec. Bank, N.A., 195 B.R. 66, 70 (S.D. Tex. 1996) ("A mineral lease in Texas is a determinable fee. It is not a lease or other form of executory contract that a debtor may accept or reject.").

185. *Id.* at 73.

186. *See In re* Clark Res., 68 B.R. 358, 359–60 (Bankr. N.D. Okla. 1986) (under Oklahoma law, an oil and gas lease is not an unexpired lease or executory contract under Bankruptcy Code § 365); *In re* Heston Oil Co., 69 B.R. 34, 36 (N.D. Okla. 1986) (an oil and gas lease is not an unexpired lease or executory contract within the purview of Bankruptcy Code § 365, but is in the nature of an estate in real property having the nature of a fee).

however, an oil and gas lease is personal property that is subject to Bankruptcy Code § 365.[187] In Pennsylvania, a lease to explore for minerals before minerals are discovered is also subject to Bankruptcy Code § 365 but transforms into a fee type interest once discovery and production has begun.[188] Some states' laws are still unclear on the matter.[189]

Whether or not a document named an oil and gas lease is in fact an executory contract or unexpired lease under the Bankruptcy Code is important because of the requirements of Bankruptcy Code § 365. This distinction determines whether or not counterparties are entitled to cure payments, the enforceability of provisions regarding assignment, notice requirements, and statutory deadlines for assumption or rejection in a bankruptcy case.

B. Federal Leases

Leases on the Outer Continental Shelf (OCS) and on federal land are governed by federal law.[190] Both are under federal control, and the federal government is the original owner of the minerals and has the right to explore and produce the minerals.[191] With respect to federal leases relating to onshore properties, federal courts have consistently held that such leasehold interests are real property interests.[192] However, the question is open regarding the nature of a property interest granted by an OCS lease.[193] The Outer Continental Shelf Lands Act (OCSLA) applies adjoining state law unless federal law overrides state law.[194] The federal law that will override state law can be statutory or federal common law.[195]

Most OCS leases are located off the coasts of Texas and Louisiana. Texas

187. UTICA Nat'l Bank & Trust Co. v. Marney, 661 P.2d 1246, 1248 (Kan. 1983) (holding that an oil and gas lease is not foreclosed by a mortgage foreclosure unless provided for by statute because a lease is personal property in Kansas); *see In re* J. H. Land & Cattle Co., 8 B.R. 237, 239 (W.D. Okla. 1981) (under Kansas law, an oil and gas lease is within the reach of [Bankruptcy Code] § 365 and may be rejected by a debtor with court approval).

188. Powell v. Anadarko E&P Co. (*In re* Powell), 482 B.R. 873, 875 (Bankr. M.D. Pa. 2012).

189. *See infra* Appendix B, for a fifty-state survey on oil and gas leases as executory contracts or unexpired leases.

190. 43 U.S.C. § 1331(a) (2012); *see also* 43 U.S.C. § 1301 (demarcating submerged lands, which includes outer continental shelf lands, as public lands, which are federally controlled).

191. 43 U.S.C. § 1332.

192. *See, e.g.*, Mafrige v. United States, 893 F. Supp. 691, 698 (S.D. Tex. 1995) (holding that an oil and gas lease under the Mineral Leasing Act is a real property interest).

193. 43 U.S.C. § 1331.

194. Union Tex. Petroleum Corp. v. PLT Eng'g, Inc., 895 F.2d 1043, 1047 (5th Cir. 1990). *See* Grand Isle Shipyard, Inc. v. Seacor Marine, LLC, 589 F.3d 778, 784 (5th Cir. 2009) (explaining that under OSCLA, "for federal law to oust adopted state law, federal law must first apply") (internal quotation marks omitted).

195. *Compare* Walter Oil & Gas Corp. v. NS Grp., Inc., 867 F. Supp. 549, 553 (S.D. Tex. 1994) (determining that federal common law does not apply under OCSLA), *with* Doucet v. Gulf Oil Corp., 783 F.2d 518, 525–26 (5th Cir. 1986) (applying federal common law). *See also Grand Isle*, 589 F.3d at 808 (Owen, J., dissenting) ("[T]he Supreme Court has left open whether state law applied as federal law under OCSLA or federal common law prevails when the result would differ depending on which body of law applied."); Shell Petroleum, Inc. v. United States, 2008 U.S. Dist. LEXIS 51180, at *16 (S.D. Tex. July 3, 2008) (likely applying federal common law and finding that "OCS leases are real property interests that are sold by the MMS").

leases are real property interests, and the majority view holds that Louisiana leases are also real property interests.[196] The question of which law to apply (adjoining state or an overriding federal law) is complicated by the fact that there are no statutes regarding whether an OCS lease is a personal or real property interest.[197] The leases are similar in nature to federal land leases; however, the United States has taken the position in recent litigation that the leases are personal property rights that may be rejected.[198]

Currently the issue of the nature of the property interests created by OCS leases (and their underlying royalties) is being contested in the bankruptcy adversary case of *NGP Capital Resources Co. v. ATP*, pending in the United States Bankruptcy Court for the Southern District of Texas, Houston Division (the "ATP Bankruptcy").[199] The Debtors have argued that the OCS leases, and thus the royalty interests derived from them, are personal property and that such leases are subject to rejection with the consequence that leaseholders and royalty holders would only hold an unsecured claim for the amount of the rejection damages.[200] On the other hand, the royalty holders argue that the leases are real property interests that the Debtor cannot reject.[201] At the time of this publication, the court has not ruled on this specific issue.

C. Royalty Claims

In most states, the failure to pay royalties does not automatically cause lease termination.[202] The exception to this general rule arises if the lease specifically

196. Terry Oilfield Supply Co., Inc. v. Am. Sec. Bank, N.A., 195 B.R. 66, 70 (S.D. Tex. 1996); Cimarex Energy Co. v. Mauboules, 40 So. 3d 931, 950 n.5 (La. 2010) ("A mineral right is an incorporeal immovable.") (internal quotation marks omitted). *But see* Texaco, Inc. v. La. Land & Exploration Co., 136 B.R. 658, 668 (M.D. La. 1992) (holding that a mineral lease is an executory contract in Louisiana).

197. *Compare* United States' Response to Motion for Summary Judgment at 4, NGP Capital Res. Co. v. ATP, No. 12-03443 (Bankr. S.D. Tex. 2012), ECF No. 82 ("Classifying the award of an OCS lease as the conveyance of a real property interest rather than a leasehold interest is inconsistent with the nature of ATP's interest in the OCS lease as defined under OCSLA."), *with* Shell Petroleum, Inc. v. United States, 2008 U.S. Dist. LEXIS 51180, at *16 (S.D. Tex. July 3, 2008) (noting that the United States stipulated that "OCS leases are real property interests that are sold by the Minerals Management Service ('the MMS') at public auction").

198. *See, e.g.*, United States' Response to Motion for Summary Judgment at 4, NGP Capital Res. Co. v. ATP, No. 12-03443 (Bankr. S.D. Tex. 2012), ECF No. 82 ("Classifying the award of an OCS lease as the conveyance of a real property interest rather than a leasehold interest is inconsistent with the nature of ATP's interest in the OCS lease as defined under OCSLA.").

199. *See, e.g.*, NGP Capital Res. Co. v. ATP Oil & Gas Corp. (*In re* ATP Oil & Gas Corp.), No. 12-36187ADV 12-03443, 2014 WL 61408 (Bankr. S.D. Tex. Jan. 6, 2014).

200. *See supra* note 198 and accompanying text.

201. *See, e.g.*, Motion for Summary Judgment at 14–22, NGP Capital Res. Co. v. ATP, No. 12-03443 (Bankr. S.D. Tex. Feb. 11, 2013), ECF No. 77.

202. *See, e.g.*, Schaffer v. Tenneco Oil Co., 647 S.W.2d 446, 447 (Ark. 1983); Cannon v Cassidy, 524 P.2d 514 (Okla. 1975); LA. REV. STAT. ANN. § 31.212.23 (2007) (giving the court discretion to dissolve the lease if there is gross abuse by the leaseholder). Additionally, a lease with the government on government property may be dissolved if the government is not paid its royalty payments. 43 U.S.C. § 1334(d) (2012).

provides otherwise or if there is applicable state law to the contrary.[203] If a lease may be cancelled for non-payment of royalties, an argument can be made that bankruptcy courts should authorize the royalty payments to be paid after the petition is filed even though such amounts represent pre-petition debts in order to avoid forfeiture of a significant asset.[204]

Royalty creditors have statutory lien rights in some states, most notably in Texas and Oklahoma,[205] but if no such lien rights exist under state law, royalty creditors are typically unsecured creditors under the Bankruptcy Code.[206] For example, Texas Business and Commerce Code § 9-343 provides a security interest in favor of interest owners to secure the obligations of the first purchaser of oil and gas production to pay for such production.[207] A first purchaser is defined under this statute as "the first person that purchases . . . production . . . or an operator that receives production proceeds from a third-party purchaser . . . under [an agreement] . . . under which the operator collects proceeds of production on behalf of other interest owners."[208] The term "interest owner" is also construed broadly to afford protection to a wide swath of royalty owners.[209]

The security interest of royalty holders in Texas is treated like a purchase money security interest and is perfected automatically without the filing of a financing statement.[210] This lien attaches to oil and gas production and also the identifiable proceeds of that production owned by, received by, or due to the first purchaser (although a bona fide purchaser from the first purchaser takes free from the lien).[211] The statute provides that a perfected royalty owner with the ability to trace proceeds will not have its interest extinguished by time, co-mingling, or the use of the proceeds for other purposes.[212] However, as

203. A lease may also terminate if the party is not paying contractually due "shut in royalties" when a lease is not producing but is so capable. Blackmon v. XTO Energy, Inc., 276 S.W.3d 600, 607 (Tex. App.—Waco 2008, no pet.).

204. *See, e.g.*, Order Granting Motion Regarding Payment of Funds, Bennu Oil & Gas, LLC v. Bluewater Industries, L.P. (*In re* ATP Oil & Gas Corp.), No. 12-36187 (Bankr. S.D. Tex. 2014), ECF No. 191.

205. *See infra* Appendix C, for a fifty-state survey of first purchaser and royalty liens.

206. Rhett G. Campbell, *Significant Issues in Oil and Gas Bankruptcy Cases* (1999), *available at* http://www.tklaw.com/files/Publication/b230f92c-d2e1-4d67-bff9-d61599254ffb/Presentation/PublicationAttachment/a1af9032-4b65-4f5a-88ac-016b4f48fc17/Significant%20Issues%20in%20Oil%20and%20Gas%20Bankruptcy%20Cases%20(Campbell,%20R.).pdf.

207. TEX. BUS. & COMM. CODE ANN. § 9.343(a) (2011).

208. *Id.* § 9.343(r)(3).

209. *In re* Tri-Union Dev. Corp., 253 B.R. 808, 812–813 (Bankr. S.D. Tex. Oct. 4, 2000) ("Consequently, th[e] definition [of interest owners] would seem to clearly include all royalty and working interest owners.").

210. TEX. BUS. & COMM. CODE ANN. § 9.343(b) & (f)(1).

211. *In re Tri-Union*, 253 B.R. at 813; TEXAS BUS. & COMM. CODE ANN. § 9.343(c)(1)(A).

212. *In re Tri-Union*, 253 B.R. at 813–814 ("When . . . the proceeds [from the sale of minerals from the first purchaser to a bona fide purchaser] are either accounts or cash proceeds, the security interest exists 'for an unlimited time.' . . . Simply stated, under section [9.343], the liens of the royalty and working interest owners in the production of its cash or account proceeds were perfected and enforceable as of the date of filing and were not susceptible to being cut off by a bona fide purchaser under state law or section 545 of the Bankruptcy Code.") (quoting TEXAS BUS. & COM. CODE ANN. § 9.343(c)(1)).

discussed in more detail below, the Texas first purchaser lien statute, like others, is not an automatic protection for royalty holders in complex bankruptcies where other states' laws regarding perfection might apply.[213]

D. Safe Harbor for Overriding Royalty Interests

Certain royalty owners have special protection under the Bankruptcy Code safe harbor of § 541(b)(4)(B). Interests carved out of the working interest can be divided into two broad categories: (1) overriding royalty interests (ORRIs), which take a percentage of production before working costs are factored in;[214] and (2) net profits interests (NPIs), which take a percentage of production minus working costs.[215] Only certain, true ORRIs—limited by time, quantity, or value realized and free from production costs[216]—are not considered property of the estate under Bankruptcy Code § 541(b)(4)(B).[217] Thus, a debtor may not avoid an ORRI holder's interests through a rejection of a contract under Bankruptcy Code § 365 because such interest is not property of the estate.[218] It does not matter whether the state law property interest is personal or real under this safe harbor. Still, parties should be mindful to structure their ORRIs so that they are true conveyances of royalties, instead of "disguised financings" that may not qualify under Bankruptcy Code § 541(b)(4)(B), with the holder instead being then treated as a creditor, not a property owner, in the case.[219]

The Bankruptcy Court for the Southern District of Texas recently issued an opinion outlining what factors might lead a court to conclude that a purported ORRI was in fact a disguised financing instead of a sale in *NGP Capital Resource Co. v. ATP Oil & Gas Corp. (In re ATP Oil and Gas).*[220] In this opinion, the bankruptcy court denied summary judgment for both sides on whether the conveyance of an interest in minerals was a true sale of an ORRI or

213. *See infra* Part IV.A.

214. Foothills Tex., Inc. v. MTGLQ Investors, L.P. (*In re* Foothills Tex., Inc.), 476 B.R. 143, 149 (Bankr. D. Del. 2012) ("An important feature of overriding royalty interests is the fact that the interest is free and clear of costs and expenses.").

215. 8 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL AND GAS LAW, MANUAL OF TERMS 603, 675 (2013).

216. 11 U.S.C. § 101(42A) (2012).

217. *Cf.* Farwell v. Comm'r, 35 T.C. 454, 465–466 (T.C. 1960) (holding that an overriding royalty is absolutely free from production costs.).

218. Though the leases to which ORRIs and NPIs attach may sometimes be rejected, due to the passive role of ORRI and NPI interests, these are most likely not executory contracts that may be rejected by an estate in the Fifth Circuit, the District of Delaware, and elsewhere. *In re Foothills*, 476 B.R. at 149; *In re* WRT Energy Corp., 202 B.R. 579, 583 (Bankr. W.D. La. 1996) (citing Murexco Petroleum, Inc. v. Yaquinto (*In re* Murexco Petroleum, Inc.), 15 F.3d 60, 62–63 (5th Cir. 1994)); Pac. Express, Inc. v. Teknekron Infoswitch Corp. (*In re* Pac. Express, Inc.), 780 F.2d 1482, 1487 (9th Cir. 1986).

219. *See, e.g.*, Grace-Cajun Oil Co. No. 3 v. Fed. Deposit Ins. Corp., 882 F.2d 1008, 1011 (5th Cir. 1989); Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 545 (3d Cir. 1979).

220. NGP Capital Res. Co. v. ATP Oil & Gas Corp. (*In re* ATP Oil & Gas Corp.), No. 12-36187, 2014 WL 61408, at *2 (Bankr. S.D. Tex. Jan. 6, 2014).

a disguised financing.[221] The bankruptcy court noted that certain aspects of the transaction suggested that the transaction was a disguised financing, most notably the fact that the interest holder did not appear to be truly at risk due to high interest rates and penalties that came into effect if production waned.[222] These rates and penalties effectively assured the interest holder that it would receive the "Total Sum" contemplated from its investment.[223] The court further noted that such terms could transform an ostensible sale into the "economic equivalent" of a loan.[224] The bankruptcy court also rejected arguments that the labeling of the transaction as a sale should be dispositive of its character; instead the substance of the transaction was pivotal in determining whether it was a sale or a financing.[225]

E. M&M Liens[226]

In many states, mechanic's and materialman's (M&M) liens are granted by state statute to parties that provide work or materials to upstream companies. These liens are created by state law, and their characteristics, duration, perfection requirements, scope, and other features vary. A fifty-state survey is attached to this Article as a reference for review of individual state M&M lien laws.[227] Some states have adopted statutes that specifically grant M&M liens to oil and gas vendors, while other states apply their general construction M&M lien statutes to grant such liens.[228] A minority of states exclude oil and gas vendors from M&M lien protection.[229] The scope of the liens that encumber oil and gas properties varies as well, with some attaching to production, the working interests (either all working interest or only the working interest owned by the operator), equipment, or other related assets.[230] For example, in Texas and Colorado, an M&M lien does not attach to a well's production[231] but does attach to the working interest owned by the operator.[232]

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221. *Id*. at *1.
222. *Id*. at *17.
223. *Id.* at *8–9.
224. *Id.* at *17 (citing Frankel's Estate v. United States, 512 F.2d 1007, 1010 (5th Cir. 1975)).
225. *Id.* at *5 (citing Howard Trucking Co., Inc. v. Stassi, 474 So.2d 955 (La. Ct. App. 1985)).
226. *See infra* Appendix D, for a fifty-state survey of the scope of M&M liens.
227. *Id.*
228. *Compare* COLO. REV. STAT. § 38-22-101 (West 2007) (granting M&M liens to certain vendors), *with* Amegy Bank Nat'l Ass'n v. Brazos M & E, Ltd. (*In re* Bigler LP), 458 B.R. 345 (Bankr. S.D. Tex. 2011) (construing Tex. Prop. Code § 53.023 liberally to find that a supplier of materials or labor in a drilling venture is awarded a mechanic's lien).
229. *See infra* Appendix D, for a fifty-state survey of the scope of M&M liens.
230. *Id.*
231. Recently, the United States Bankruptcy Court for the Western District of Texas has ruled that, given that a Texas M&M mineral lien does not attach to proceeds, a M&M lienholder could not assert a claim for adequate protection for the Debtor's use of cash proceeds during a bankruptcy. TXCO Res., Inc. v. Peregrine Petroleum, L.L.C. (*In re* TXCO Res., Inc.,) 475 B.R. 781 (Bankr. W.D. Tex. 2009). Accordingly, a M&M lien holder in Texas and other States that do not have a lien on proceeds will need to demonstrate some other kind of risk of depreciation to be entitled to adequate protection. Notably, a Texas case holds that a mineral lien party may have a lien against production. Abella v. Knight Oil Tools, 945 S.W.2d 847, 851 (Tex. App.—Houston [1st Dist.] 1997, no writ).
232. COLO. REV. STAT. §§ 38-22-101, 38-22-133; TEX. EST. CODE ANN. §§ 53.001–53.260, 56.001,

In Mississippi, on the other hand, the M&M lien only attaches to fixed machinery or buildings.[233] States such as Utah, Oklahoma, and Nebraska grant M&M lien holders a lien on the oil and gas produced,[234] while Wyoming grants M&M holders a lien on oil and gas produced, but not when that oil and gas is owned by a separate owner other than the contracting party, such as a royalty holder.[235] In all states M&M liens need to be perfected in order to potentially have superior priority against any liens attaching to oil and gas property interests held by other creditors such as financial parties.[236]

When attempting the often complex administrative task of identifying and analyzing the extent of M&M liens that encumber a specific oil and gas property, parties should keep in mind the type of index an individual state possesses. The majority of states, including Texas,[237] have a grantor/grantee system by which liens can be identified by examining the records of names of the owners and their transferees with respect to the property.[238] However, a minority of states, including Oklahoma, have a "tract" indexing system,[239] requiring the examination of records by reference to specific tract descriptions. This is important because failure to index correctly under state law may cause liens to be unperfected. For example, in *In re Cornerstone*, the Court ruled that the lender failed to describe the tracts that the liens were intended to encumber sufficiently under the Oklahoma tract indexing system, and thus the lender's mortgage did not put subsequent M&M lien claimants on constructive notice, causing the subsequent M&M lien holders to have a higher priority than the bank with respect to such tracts.[240]

Under Bankruptcy Code § 546(b), the rights and powers of a trustee under the avoidance actions in Bankruptcy Code §§ 544, 545, and 549 are subject to any M&M lien law that (a) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or (b) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such

56.045 (West 2014); TEX. CIV. PRAC. & REM. CODE ANN. § 12.002 (West 2002); Mid-Am. Petroleum, Inc. v. Adkins Supply, Inc. (*In re* Mid-Am. Petroleum, Inc.), 83 B.R. 937, 944 (Bankr. N.D. Tex. 1988) ("The Claimants asserted that MAP, as the operator, was the agent for the Non-Operators and, as a consequence, the interests of the Non-Operators were subject to their liens. This contention cannot be sustained either as a matter of procedure or as a matter of law.") (interpreting Texas state law).

233. MISS. CODE. ANN. §§ 85-7-131–157 (2011).

234. NEB. REV. STAT. §§ 52-110-159 (2010); OKLA. STAT. tit. 42, §§ 141-42-180 (2011); UTAH CODE ANN. §§ 38-1a-1-29, 38-10-101 to -105, 38-11-101 to -302 (LEXIS 2011).

235. WYO. STAT. ANN. §§ 29-3-103–105 (2013).

236. This applies as well for M&M liens on OCS properties, so parties should file their liens with the appropriate governmental body of the adjoining parish or county of the rig. Union Tex. Petroleum Corp. v. PLT Eng'g, Inc., 895 F.2d 1043, 1052 (5th Cir. 1990).

237. Texas Consol. Oils v. Bartels, 270 S.W.2d 708, 711–12 (Tex. Civ. App.—Eastland 1954).

238. *Id.* (finding a grant of all rights, title, and interest in "all the [oil and gas] located anywhere within the United States" sufficient where transferor was identified).

239. OKLA. STAT. tit. 19, § 298.

240. Baker Hughes Oilfield Operations, Inc. v. Union Bank of Ca., N.A. (*In re* Cornerstone E&P Co., L.P.), 436 B.R. 830, 854–55 (Bankr. N.D. Tex. 2010).

maintenance or continuation.[241] If the applicable M&M lien law requires seizure of property or commencement of an action to accomplish perfection, or maintenance or continuation of perfection of an interest in property, and such property has not been seized or such an action has not been commenced before the date of the filing of the petition, then such interest in property can be perfected, or perfection of such interest can be maintained or continued, by the M&M lien creditor giving notice to the Debtor within the time fixed by law for the seizure or commencement.[242] As such, M&M lien creditors typically file "546 Notices" in cases where they assert M&M liens against property of the bankruptcy estate.[243]

A complicated area of the law exists regarding whether creditors that would otherwise obtain M&M liens may perfect liens post-petition when their pre-petition debt has already been paid in the hopes of avoiding being forced to disgorge previously paid amounts in a preference or avoidance action. Most states' lien statutes require that a debt exist for a M&M holder to file a lien, and thus some courts have ruled that parties have violated the automatic stay by perfecting M&M liens post-petition when they were previously paid in full pre-petition.[244] In such instances, the filing of M&M lien statements was determined to be outside the scope of the state M&M statute because a debt did not then exist.[245] However, parties may still be able to protect themselves from preference actions by virtue of the fact that they *could* have filed for perfection.[246]

M&M creditors may file 546 Notices or may perfect a lien even though most creditors are enjoined from perfecting a lien after the filing of a bankruptcy case without obtaining approval from the bankruptcy court for relief from the automatic stay under the statutory protection of § 362(b)(3).[247] Normally, if a party takes an action regarding their lien without court permission, they face actual or punitive damages for violation of the automatic stay.[248] However, M&M claimants enjoy a statutory protection for perfecting liens after the filing

241. 11 U.S.C. § 546(b)(1) (2012).

242. 11 U.S.C. § 546(b)(2).

243. *See, e.g.*, Village Nurseries dba S. Counties Landscape v. Goudl (*In re* Baldwin Builders), 232 B.R. 406, 413 (B.A.P. 9th Cir. 1999).

244. Injunction against Knight Oil Tools LLC at 3, Delta Petroleum Corp. v. Knight Oil Tools LLC, No. 12-150407 (Bank. D. Del. March 23, 2012); Injunction against Baker Hughes Oilfield Operations, Inc. at 3, Delta Petroleum Corp. v. Baker Hughes Oilfield Operations, Inc., No. 12-50408 (Bank. D. Del. March 23, 2012).

245. *Id.*

246. Trustee John Patrick Lowe v. Palmetco Inc. (*In re* N.A. Flash Found.), 298 Fed. App'x 355, 359 (5th Cir. Oct. 31, 2008) (this view has not been completely adopted by the Fifth Circuit and other courts, which demand the imagined reconstruction of a case to a Chapter 7 liquidation to prove that a M&M claimant was fully secured); Electron Corp. v. JCOR (*In re* Electron Corp.), 336 B.R. 809, 813 (B.A.P. 10th Cir. 2006). *But see* Official Comm. of Unsecured Creditors of 360Networks (USA) Inc. v. AFF-McQuay, Inc. (*In re* 360Networks (USA) Inc.), 327 B.R. 187, 191 (Bankr. S.D.N.Y. 2005).

247. 11 U.S.C. § 362(a)(4) (prohibiting a creditor from taking "any act to create, perfect or enforce any lien against property of the estate").

248. *See, e.g.*, Jove Eng'g, Inc. v. I.R.S. (*In Re* Jov Eng'g, Inc.), 92 F.3d 1539 (11th Cir. 1996).

of bankruptcy under Bankruptcy Code § 362(b)(3)[249] and may perfect their statutory liens without violating the automatic stay. This exception was meant to protect M&M lienholders from the "surprise" of a bankruptcy filing, which would take away their state law statutory protection.[250]

Bankruptcy Code § 362(b)(3) applies because most state M&M lien statutes allow perfection to "look back" to the time that the work began or supplies were delivered to the Debtor as long as the M&M lien is filed correctly and within the statutory period.[251] Thus, parties that performed pre-petition work but failed to perfect their liens before the filing of a bankruptcy will be permitted to perfect their interest after the bankruptcy filing. In some states, the M&M lien priority relates back to the time the M&M claimant first provided work on the well, potentially giving the claimant the opportunity to prime competing perfected interests.[252]

249. 11 U.S.C. § 362(b)(3).

250. S. REP. NO. 95-989, at 86 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6327.

251. *See* Appendix D, for a fifty-state survey of the scope of M&M liens.

252. Yobe Elec. Inc. v. Graybar Elec. Co. (*In re* Yobe Elec. Inc.), 728 F.2d 207, 208 (3d Cir. 1984); *In re* Aznoe Agribiz Inc., 416 B.R. 755, 765–66 (Bankr. D. Mont. 2009).

F. Bankruptcy Code § 503(b)(9) Administrative Claims and State Law Reclamation

Under Bankruptcy Code § 503(b)(9), certain vendors and suppliers have an administrative claim for the value of any goods delivered within twenty days before the bankruptcy filing.[253] This is beneficial, as administrative claims must be paid for a plan of reorganization or liquidation to be confirmed and are given a higher priority than other unsecured creditors.[254] If classified as "goods," pipe, drilling mud, and other oilfield consumables sold to the Debtor without payment within twenty days of the petition date may fall under this statutory protection.[255] Indeed, gas delivered has also been held to be a "good" under Bankruptcy Code § 503(b)(9).[256] The amount that a creditor may recover for goods sent, however, is not settled. The value may be the market price at the time of receipt, or it might be the contract price between the parties.[257]

There is currently a dispute as to whether Bankruptcy Code § 503(b)(9) applies only to vendors that deliver "goods" in a traditional sense or can be expanded to contractors that provide services that result in the receipt of a benefit that is severable from skill or talent such as a power company that provides electricity. Some courts have ruled that things such as electrical power are not traditional goods protected under Bankruptcy Code § 503(b)(9) if they are "not movable at identification."[258] Other courts, however, have ruled that things such as electricity are something more than a service and are goods under Bankruptcy Code § 503(b)(9).[259]

If a party sells a hybrid of goods and services, as is often the case with upstream energy companies, the creditor may collect the value of the goods delivered within twenty days of the filing and hope to collect the value of services by other means such as filing a general unsecured claim. In the meantime, courts will continue to struggle with whether more amorphous value provided to the estate such as electricity are goods covered under Bankruptcy Code § 503(b)(9).[260]

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253. 11 U.S.C. § 503(b)(9).

254. *Id.* §§ 503, 1129.

255. Additionally, work done to improve an oil and gas estate after the petition is filed may qualify as an administrative expense. Compass Bank v. N. Am. Petroleum Corp. USA (*In re* N. Am. Petroleum Corp. USA), 445 B.R. 382, 400–402 (Bankr. D. Del. 2011), *vacated* (June 22, 2011)) (holding that the operators had administrative expense claim against estates for all saltwater disposed of by operators postpetition).

256. *In re* NE Opco, Inc., 501 B.R. 233, 237 (Bankr. D. Del. 2013) (stating "it is undisputed that natural gas is a good [under § 503(b)(9)]").

257. *In re* Pilgrim's Pride Corp., 421 B.R. 231, 242–43 (Bankr. N.D. Tex. 2009) ("Congress thus, pointedly, left to the courts determination of value to a debtor of goods received, rather than simply providing priority treatment for any claim arising from the delivery of goods. . . . Congress, in section 506(a)(1), has recognized that the same property may be valued differently depending on the circumstances."). The court ultimately found value of natural gas was market price and not contract price under Bankruptcy Code § 503(b)(9). *Id.* at 243–44.

258. *Id*. at 237; *see also In re* NE Opco, Inc., 501 B.R. at 259–260; *In re* Samaritan Alliance, LLC, No. 07-50735, 2008 WL 2520107, at *4 (Bankr. E.D. Ky. June 20, 2008).

259. GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 798–800 (W.D. Wis. 2010).

260. Hudson Energy Servs., LLC v. A&P (*In re* Great Atl. & Pac. Tea Co.), 498 B.R. 19, 22–24

Additionally, a party may also assert state law reclamation rights, which are immune from the automatic stay by virtue of Bankruptcy Code § 546(c) through statutes such as Texas Business and Commerce Code § 2.702 (which allows a seller to reclaim goods upon the discovery of a buyer's insolvency).[261] There is debate as to whether the Bankruptcy Code provides a substantive remedy for reclamation, but parties may still use state law to assert a reclamation claim for goods sent in addition to the potential receipt of cash for an administrative claim pursuant to Bankruptcy Code § 503(b)(9).[262]

G. Joint Operating Agreements

JOAs are common in the oil and gas industry and typically govern the relationship among working interest owners. JOAs are frequently based on a form issued by the American Association of Petroleum Landmen (AAPL), last modified in 1989.[263]

Numerous provisions in the AAPL model form of JOA are implicated during a reorganization, such as the holding and application of funds by the operating working interest owner,[264] the covenant to keep the working interest free and clear of liens,[265] detailed authorization for expenditures provisions setting forth funding of work and the effect of failing to fund,[266] the process for funding and participations in subsequent operations of the well,[267] joint interest billings (JIBs) to be paid by non-operating working interest owners to the operator, granting of liens and security interests,[268] preferential rights to purchase or consent rights,[269] memorandums of the JOA for public filing purposes,[270] and recoupment by working interest owners.[271] The AAPL form can be modified by parties and often contains provisions unique to the specific transaction.[272] These additions and non-standard provisions may greatly impact the treatment and issues relating to a JOA in the reorganization process.

If one party to a JOA files for bankruptcy, the counterparty could be left

(S.D.N.Y. 2013) (remanding the issue to bankruptcy court for evidentiary hearing).

261. 11 U.S.C. § 362(b)(24) (2012).

262. Rhett G. Campbell, *A Survey of Oil and Gas Bankruptcy Issues*, 5 TEX. J. OIL GAS & ENERGY L. 265, 286 (2010).

263. Four forms have been issued by the AAPL, in 1956, 1977, 1982, and 1989. Timothy W. Dowdy, *A.A.P.L. Form 610 Model Operating Agreement: Selected Provisions Impacting Onshore Producing Property Transfers*, 47 ROCKY MTN. MIN. L. INST. 13 (2001).

264. 7 WEST'S TEX. FORMS, MINERALS, OIL & GAS § 13:1 (4th ed. 2013) (addressing the Model Form Operating Agreement—A.A.P.L. Form 610-1989).

265. *Id.* art. VI(B)(2)(b).

266. *Id.* art. VII.

267. *Id.* art. VI(B).

268. *Id.* art. VII(B).

269. *Id.* art. VIII(F).

270. *Id.* art. XIII.

271. *Id.* art. VI(B).

272. Mark A. Mathews & Christopher S. Kulander, *Additional Provisions to Form Joint Operating Agreements*, OIL, GAS & ENERGY RESOURCES LAW SECTION REPORT, STATE BAR OF TEXAS, Vol. 33, No. 2, at 39–40 (Dec. 2008) (many "old hands" have standardized this Article VI flexibility to their own wishes when negotiating JOAs).

with significant pre-petition claims as well as additional issues in operations. For this reason, parties seek to have their rights under the JOA secured by contractual liens. The AAPL-form JOA grants counterparties consensual liens in the property subject to the JOA and related collateral.[273] These liens, while potentially valuable for JOA parties, are not perfected automatically and must be properly perfected under applicable state law. Like other consensual liens, there is a potential that other liens may pre-date and be superior to JOA liens.[274]

Another possible remedy for a party is the right of recoupment in a JOA.[275] Recoupment is similar to "netting-out" but only applies to a singular contract or transaction.[276] A JOA that allows recoupment will allow a creditor JOA party to withhold amounts owed under the contract to offset debts under the same contract.[277] Recoupment applies to both pre-petition and post-petition debts,[278] and in exercising a recoupment right a party does not violate the automatic stay.[279] Parties should be cautious, however, in case there is disagreement over whether recoupment is allowed under the JOA, whether the JOA is a single agreement, or whether the court has issued an order forbidding recoupment.

H. JOA Executory Contract Issues: Assumption and Rejection

A JOA may be considered an executory contract subject to Bankruptcy Code § 365.[280] As an executory contract, it may be rejected in a bankruptcy case. After rejection, the working interests in the project are not eliminated, and in most states the parties' relationship is governed by the laws of co-tenancy.[281] An alternative to rejection is the assumption, or assumption and assignment, of the JOA by the bankruptcy estate. If the Debtor elects to assume the contract, it must cure all defaults under the JOA, and these cure costs must be paid

273. 7 WEST'S TEX. FORMS, MINERALS, OIL & GAS § 13:1 at art. VII(B).

274. A lien is valid when agreed to between contracting parties. TEX. EST. CODE ANN. § 13.001(b) (West 2014); Floyd v. Rice, 444 S.W.2d 834, 836 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.). Perfection is only relevant when there are competing claims on the collateral. *See, e.g.*, TEX. EST. CODE ANN. § 13.001(a).

275. Lightfoot v. Huffman (*In re* Brown), 325 B.R. 169, 175–76 (Bankr. E.D. La. 2005) ("Setoff is asserted to reduce or extinguish a creditor's claim against the Debtor when the mutual debt and claim contemplated are generally those arising from different transactions. . . . Recoupment, on the other hand, is the setting up of a demand arising from the same transaction as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim.") (internal quotation marks omitted).

276. Kosadnar v. Metro. Life Ins. Co. (*In re* Kosadnar), 157 F.3d 1011, 1015 (5th Cir. 1998) ("There is no general standard governing whether events are part of the same or different transactions. 'Given the equitable nature of the [recoupment] doctrine, Courts have refrained from precisely defining the same-transaction standard, focusing instead on the facts and the equities of each case.'" (alteration in original) (quoting United States *ex rel.* U.S. Postal Serv. v. Dewey Freight Sys., Inc., 31 F.3d 620, 623 (8th Cir. 1994)).

277. Also, parties may have common law recoupment rights.

278. Sacramento Mun. Util. Dist. v. Mirant Ams. Energy Mktg., LP *(In re* Mirant Corp.), 318 B.R. 377, 381–82 (Bankr. N.D. Tex. 2004).

279. *See* Malinowski v. N.Y. State Dep't of Labor (*In* re Malinowski), 156 F.3d 131, 133 (2d Cir. 1998); Holford v. Powers (*In re* Holford), 896 F.2d 176, 179 (5th Cir. 1990).

280. Wilson v. TXO Prod. Corp. (*In re* Wilson), 69 B.R. 960, 963 (Bankr. N.D. Tex. 1987).

281. *Id*.

promptly upon assumption, or the Debtor must provide adequate assurance that it will promptly cure such defaults.[282] Assumption of a JOA by a debtor is often preferred by a JOA counterparty because the alternative of rejection results in a potential unsecured claim, co-tenancy, and no required curing of defaults (although a party may qualify for an administrative claim if it provides qualifying benefits to the estate).

As noted above, the time between the petition date and any rejection or assumption of the JOA has been referred to as the "twilight zone" because an executory contract is enforceable by, but not against, a debtor-in-possession.[283] Until an executory contract has been assumed or rejected, the Bankruptcy Code relieves the Debtor of his or her duty to perform,[284] but, whether the Debtor performs or not, the non-Debtor must perform until assumption or rejection.[285] Indeed, in a refinery case, one court stated:

> Until [assumption or rejection] . . . the status of the non-debtor party's claims against the estate is held in *stasis*, pending the estate's decision. Were it otherwise, this party would enjoy a privileged position *vis-a-vis* other creditors, able to use the estate's need for the contract to extract special treatment, even though the contract might ultimately be rejected and the creditor would thereafter have no priority over other unsecured creditors. Until the estate elects to assume the contract, with the approval of the court, and with prior notice and opportunity for hearing to other creditors, the Bankruptcy Code deems it inappropriate to accord the non-debtor party to an executory contract any special position or influence.[286]

In *In re Wilson*, the court found that in the "twilight zone" there was at first no enforceable contract and the local law of co-tenancy applied.[287] Under Texas co-tenancy law, when one co-tenant incurred expenses beneficial to the property, that co-tenant could deduct its reasonable costs from oil and gas received before accounting to the non-participating co-tenant for their share of production.[288] Thus, the court found that post-petition production could be

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282. 11 U.S.C. § 365(b)(1) (2012).

283. *See* N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 532 (1984); United States *ex rel.* U.S. Postal Serv. v. Dewey Freight Sys, Inc., 31 F.3d 620, 624 (8th Cir. 1994); Univ. Med. Ctr. v. Sullivan (*In re* Univ. Med. Ctr.), 973 F.2d 1065, 1075 (3d Cir. 1992); *In re* Broadstripe, LLC, 402 B.R. 646, 656 (Bankr. D. Del. 2009); Interstate Gas Supply, Inc. v. Wheeling Pittsburgh Steel Corp. (*In re* Pittsburgh-Canfield Corp.), 283 B.R. 231, 238 (Bankr. N.D. Ohio 2002); Allied Fire & Safety Equip. Co. v. Dick Enters., Inc., 972 F. Supp. 922, 928 (E.D. Pa. 1997); *In re* THW Enters., Inc., 89 B.R. 351, 354 (Bankr. S.D.N.Y. 1988); *In re* Wilson, 69 B.R. at 966.

284. Krafsur v. UOP (*In re* El Paso Refinery, L.P.), 196 B.R. 58, 72 (Bankr. W.D. Tex. 1996).

285. Pub. Serv. Co. of N.H. v. N.H. Elec. Coop., Inc. (*In re* Pub. Serv. Co. of N.H.), 884 F.2d 11, 14 (1st Cir. 1989) (stating that creditors are bound to honor executory contracts until the Debtor commits itself to assumption or rejection); *In re* Mirant Corp., 303 B.R. 319, 328 (Bankr. N.D. Tex. 2003); *In re El Paso Refinery*, 196 B.R. at 72.

286. *In re El Paso Refinery*, LP, 220 B.R. 37, 43 (Bankr. W.D. Tex. 1998).

287. *In re Wilson*, 69 B.R. at 965–66.

288. *Id*.

charged against post-petition obligations.[289] The Debtor could offset post-petition benefits but still had to account to its counterparty as the Debtor was still reaping the benefits of the oil and gas production.[290] This case has been criticized by some commentators.[291] The powers of parties when the Debtor is an operator in the twilight zone has not been definitively decided under case law.[292]

I. Alternatives to JOAs

A JOA, although preferred, is not mandatory for multiple working interest owners to produce oil and gas. In most states, the default legal relationship of parties with interests in the same oil and gas lease is that of "co-tenants," with both parties being allowed to exploit the minerals.[293] An accounting is commonly required by the risk-taking party if minerals are produced.[294] Co-tenants in most states do not owe each other any heightened duty,[295] and because the non-producing tenant is entitled to an accounting and payment of proceeds after costs are paid, the non-producing co-tenant generally gets a free look at the quality of the well with the producing co-tenant taking all the risk.[296] This free rider issue, the limited rules for production, and the undefined ongoing relationship between the working interest owners makes co-tenancy a less preferred means to exploit minerals for many oil and gas companies.

Additionally, a lessee may "pool" adjoining tracts of land into one singular tract in terms of payment, which often permits the lessees to meet the minimum well spacing requirements. Pooling essentially "effects a cross-conveyance among the owners of minerals under the various tracts . . . so that they all own undivided interest under the unitized tract."[297] While pooling is allowed in a voluntary fashion in most states, it may be forced upon mineral interest owners in some states such as Oklahoma[298] and Pennsylvania.[299] Pooling is highly state law specific, and the specifics of the state pooling statute will determine the effect of its pooling regime on the bankruptcy and reorganization process.

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289. *Id.*
290. *Id.*
291. Rhett G. Campbell, *A Survey of Oil and Gas Bankruptcy Issues*, 5 TEX. J. OIL GAS & ENERGY L. 265, 303–04 (2010) (stating *Wilson* reaches a "harsh" and "improper" result); s*ee also* Charles A. Beckham Jr. et. al., *Oil and Gas Leases: They're Not Just in Texas Anymore; They're Fracking Everywhere!*, 32nd Annual Jay L. Westbrook Bankruptcy Conference, November 21-22, 2013, Austin, Texas, p. 7 (questioning the holding of Wilson and the fact that a JOA should be considered an executory contract entirely, instead of being split into executory and non-executory parts).
292. *See supra* note 276 and accompanying text.
293. 1 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL & GAS 140–41 (1987).
294. *In re Wilson*, 69 B.R. at 963.
295. Britton v. Green, 325 F.2d 377, 383 (10th Cir. 1963).
296. KUNTZ, *supra* note 293, at 140–41.
297. Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968).
298. OKLA. STAT. tit. 52, § 87.1 (2011).
299. 58 PA. STAT. ANN. § 34.1 (West 2001).

J. Farmouts and Bankruptcy Code § 541(b)(4)(A)

Bankruptcy Code § 541(b) states:

> Property of the estate does not include—
>
> . . . .
>
> (4) any interest of the [D]ebtor in liquid or gaseous hydrocarbons to the extent that—
>
> (A)(i) the [D]ebtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement.[300]

Further, the code defines the term "farmout agreement" as a written agreement in which:

> (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 a 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 or gaseous hydrocarbons on the property.[301]

Only one case, *Texas Gas Corp. v. Forcenergy Onshore, Inc.*, has substantively addressed Bankruptcy Code § 541(b)(4)(A).[302] *Texas Gas* stated that under Bankruptcy Code § 541(b)(4)(A) the term "farmout" has been "interpreted more broadly than is typical in the oil and gas industry."[303] This opinion was referring to the potentially expansive statutory definition given to farmout agreements in the Bankruptcy Code that goes beyond the typical requirement that the farmee actually drill or become primarily responsible for the operation's success. This statement in *Texas Gas* does appear to be dicta, as the dispute was between a farmor corporation and a farmee driller.[304] However, the text of the statute coupled with the legislative history of Bankruptcy Code § 541(b)(4)(A) does suggest that the term farmout possibly extends to vendors that provided auxiliary services on a drill site. Indeed, the legislative history seems not only concerned with blocking financiers from

300. 11 U.S.C. § 541(b)(4)(A) (2012).

301. 11 U.S.C. § 101(21A).

302. *See* TransTexas Gas Corp. v. Forcenergy Onshore, Inc., No. 13-10-00446-CV, 2012 WL 1255218 (Tex. App.—Corpus Christi 2012, pet. denied).

303. *Id.* at *7 (citing R. Campbell & D. Bennett, *Bankruptcy in the New Millennium: Energy, Insolvency and Enron*, 48 ROCKY MTN. MIN. L. INST. 18, 19 (2002)).

304. *Id.*

seeking protection from the farmout exception[305] but also with protecting "very small businesses" that perform work on an oil and gas site, even if that work is not substantial.[306]

K. Plugging and Abandonment

1. Abandonment Under the Bankruptcy Code

Under Bankruptcy Code § 554, the trustee or estate may abandon property so that the abandoned property's liabilities and responsibilities will vest in the Debtor entity with the bankruptcy estate being cleared of these future burdens.[307] This ability to abandon property under the Bankruptcy Code often conflicts with the statutory obligation of a well operator to properly plug its shut-in wells because every well that is drilled must eventually be plugged when it stops producing.[308] The plugging process is expensive, and bankrupt parties with cash flow issues often struggle to fund these obligations. Therefore, governmental entities and contractual counterparties often require the posting of bonds that can only be redeemed after a well is plugged or after the operator posts other financial assurances.[309]

The Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection* 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.[310] *Midlantic* stated in a footnote:

> 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

305. *See* H.R. REP. NO. 102-474, at 8–10 (1992), *reprinted in* 1992 U.S.C.C.A.N. 2271, 2277 ("The protection of the amendment is not intended to apply to parties loaning funds to farmors or to other passive financial participants. As Ken N. Klee, testifying on behalf of the National Bankruptcy Conference noted: '[The statutory language is] only going to protect the farmee and the farmees creditors. . . . [The definition of farmout agreement] requires the entity to perform drilling, rework, and do other kinds of things on the property. The investors, who go ahead and act as participants with respect to the owners interest in this, don't do that. So the farmee is going to be protected by this, but the participants who invest in the farmor are not.'") (alterations in original) (quoting Ken N. Klee's testimony before the Subcommittee on Economic and Commercial Law).

306. *See id.* ("'[The focus of the oil and gas farmout legislation is] very small business[es]. They operate many times drilling on their neighbor's land. They're in very rural areas of the United States for the most part. [The legislation is] not something that is going to go as a big windfall to a large company. In fact, it's probably just the reverse, because as was pointed out, the situation is that many of the larger companies are the ones who farm out properties, so the situation is its mostly small companies out there that this [bill] will provide equity to.'") (alterations in original) (quoting testimony before the Subcommittee on Economic and Commercial Law).

307. 11 U.S.C. § 554 (2012).

308. Plugging and abandonment is a distinct obligation for a debtor's right to abandon property. *In re* Am. Coastal Energy Inc., 399 B.R. 805, 809–810 (Bankr. S.D. Tex. 2009).

309. *See, e.g.*, TEX. NAT. RES. CODE ANN. § 91.104 (West 2014). Additionally, some parties may be exempted from having to post a bond if they are viewed as financially secure enough.

310. Midlantic Nat'l Bank v. N.J. Dep't of Env't Prot., 474 U.S. 494, 495 (1986).

> 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.[311]

Courts following *Midlantic* have split in interpreting this exception. The majority view holds that the exception to the trustee's abandonment power only arises when there is likely imminent harm to the public.[312] Under this analysis, whether property is currently not in compliance with environmental or other regulatory law is merely a precursor to the estate being barred from its abandonment power.[313] For example, in *Guterl Special Steel Corp.*, the court found that even though a parcel of the Debtor's property that had at one point been used to enrich uranium was in violation of state law regarding radioactivity levels, this land did not pose an imminent danger because it had not been tended to for eight years and the relevant enforcement agency's apathy was only broken by the Debtor filing for bankruptcy.[314] Thus, the court allowed abandonment of the property even though the Debtor had unfulfilled legal and environmental duties concerning the land.[315]

Courts in the Fifth Circuit have addressed the estate's ability to abandon property that contains unplugged wells under *Midlantic*. In *In re H.L.S.*, the Fifth Circuit addressed whether an estate could have abandoned wells with outstanding plugging liability.[316] The Fifth Circuit held, "[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."[317]

Thus, the Fifth Circuit held that the Trustee in *H.L.S.* was forbidden from abandoning the property that had outstanding plugging liability without addressing the question of whether there was a risk of imminent harm to the public.[318]

The *American Coastal* court relied on *H.L.S.* in taking a bright line approach to the duty of the estate to plug wells, explicitly eschewing any "imminent harm" test.[319] The court held that the inquiry as to whether the Trustee could abandon property ended if the property that the estate sought to abandon was in

311. *Id.* at 507 n.9.

312. *In re* Old Carco LLC, 424 B.R. 650, 661 (Bankr. S.D.N.Y. 2010); *In re* Unidigital, Inc., 262 B.R. 283, 286–87 (Bankr. D. Del. 2001) (listing cases); *In re* Nat'l Gypsum Co., 139 B.R. 397, 413 (N.D. Tex. 1992); John W. Ames & David W. Houston IV, *Toxins-Are-Us: Abandonment of Contaminated Land: A Toxic Quandary*, 24-7 AM BANKR INST. J. 40, 41 (2005).

313. Ames, *supra* note 312, at 40.

314. *In re* Guterl Special Steel Corp., 316 B.R. 843, 858 (Bankr. W.D. Pa. 2004).

315. *Id.* at 861.

316. Tex. v. Lowe (*In re* H.L.S. Energy Co.), 151 F.3d 434, 436 (5th Cir. Tex. 1998).

317. *Id.* at 438 (citation omitted).

318. *Id.* at 434.

319. *In re* Am. Coastal Energy, 399 B.R. 805, 813 (Bankr. S.D. Tex. 2009); *In re H.L.S. Energy*, 151 F.3d at 436.

violation of environmental law, as environmental law was meant to protect the public, and the court did not believe it was proper for it to engage in an analysis of whether an environmental violation was truly dangerous.[320]

The court in *American Coastal* did note, "[T]he Supreme Court [in *Midlantic*] has left open the possibility that environmental liabilities may be so significant in relation to the debtor's ability to pay that characterizing all or a portion of an environmental claim as an administrative expense may unduly 'interfere with the bankruptcy adjudication itself.'"[321] Though the court noted that there was no danger to the bankruptcy process,[322] the inclusion of the quote in the opinion suggests that in an extraordinary case the court might be amenable to entertaining an argument that the Debtor could abandon properties if the alternative was devastating to a bankruptcy case. Though the same court was not persuaded in a later case to loosen its holding from *American Coastal* when the Debtor argued that it should permit abandonment because a co-obligor, non-debtor was liable for these claims.[323]

2. Administrative Claim

The issue of whether a governmental unit that undertakes clean-up, plugging and abandonment, or other remediation costs would be able to bring an administrative claim or would simply have an unsecured claim is related to the above analysis of whether the estate can abandon burdensome property. If the property cannot be abandoned, then the estate will be more likely to have benefitted from any costs that are necessary to keep the property in a legal and safe condition.[324] Additionally, in order for a claim to be administrative, it needs to arise post-petition.[325]

In *H.L.S.*, the Fifth Circuit addressed wells that had ceased production one year prior to the bankruptcy case and ones that ceased production during the bankruptcy and, according to Texas law, needed to be plugged within one year after their disuse.[326] These wells were plugged by the state of Texas, which brought an administrative claim for its work.[327] As the deadline for plugging all wells occurred after the bankruptcy petition, plugging liability outstanding for these wells arose post-petition.[328] The *H.L.S.* court therefore found that as

320. *In re Am. Coastal*, 399 B.R. at 813.

321. *Id.* at 814 (quoting Midlantic Nat'l Bank v. N.J. Dep't of Env't Prot., 474 U.S. 494, 507 (1986)).

322. *Id.*

323. *In re* ATP Oil & Gas Corp., No. 12-36187, 2014 WL 1047818, at *7–8 (Bankr. S.D. Tex. March 18, 2014).

324. *See, e.g.*, *In re* Insilco Techs., Inc., 309 B.R. 111, 115 (Bankr. D. Del. 2004) ("[C]ourts have found that when a debtor cannot abandon property, the costs incurred by a State agency to remediate it will be accorded administrative expense treatment because the expenses incurred to remove the threat are necessary to preserve the estate."); *In re* Unidigital, Inc., 262 B.R. 283, 289 (Bankr. D. Del. 2001).

325. *See, e.g.*, *In re* Pugh Shows, Inc., 307 B.R. 50, 57 (Bankr. S.D. Ohio 2004).

326. H.L.S. Energy Co. v. Lowe, 151 F.3d 434, 434 (5th Cir. 1998).

327. *Id.* at 436.

328. *Id.* at 438.

the estate was saddled with the post-petition duty to plug wells, the plugging work undertaken was a benefit to the estate and the state of Texas could have an administrative claim for the plugging of the wells.[329]

The *American Coastal* court expanded *H.L.S.*'s scope and found that, though the need for plugging might have initially arisen pre-petition, any work done in furtherance of plugging and abandonment post-petition could qualify for an administrative expense claim.[330] As the court in *American Coastal* explained, plugging and abandonment obligations were "continuing" and "ar[ose] anew with the passage of each day."[331] Thus, outstanding plugging and abandonment obligations that arose pre-petition may be considered as post-petition, administrative claims.[332]

L. Sales Under Bankruptcy Code § 363

Bankruptcy Code § 363 has become one of the most useful statutes under the Bankruptcy Code in energy reorganizations because it permits sales of bankruptcy estate property "free and clear" of liens.[333] The trustee may sell property under Bankruptcy Code § 363 free and clear of any interest in such property of an entity other than the estate, 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.[334]

These interests include liens, claims, and certain encumbrances but do not generally include easements or covenants that run with the land.[335] 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

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329. *Id.* at 434.

330. *In re* Am. Coastal Energy, 399 B.R. 805, 813 (Bankr. S.D. Tex. 2009) (citing *In re* Nat'l Gypsum Co., 139 B.R. 397, 413 (N.D. Tex. 1992)).

331. *Id.* at 811.

332. *Id.*

333. *See* 11 U.S.C. § 363(f), (g) (2014).

334. 11 U.S.C. § 363(f).

335. *See, e.g.*, Newco Energy v. Energytec, Inc. (*In re* Energytec, Inc.), 739 F.3d 215, 224–25 (5th Cir. 2013) (transportation fees and rights attached to gas pipeline are covenants running with the land and, thus, are "interests"); Gouveia v. Tazbir, 37 F.3d 295, 299–300 (7th Cir. 1994).

protections.[336] 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.[337] 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.[338] Even in such case, there may be cash payments required as part of the credit bid as shown by the ATP Bankruptcy where the court approved a sale of a substantial amount of the Debtor's assets through a credit bid of the Debtor-in-possession lender where certain senior M&M lienholders received, in cash, the full value of their secured lien claims on the assets.[339] Therefore, the DIP lender, though its total bid for the assets was far less than its total debt, paid $55 million into a cash reserve fund to pay off certain senior M&M lien holders. Though the modern trend is becoming more and more favorable to using Bankruptcy Code § 363 as an end-goal of many complex reorganizations,[340] some courts prohibit or limit such sales as impermissible "sub rosa" plans (the Debtor undertaking activities that are essentially a bankruptcy plan without following plan procedures) when the Debtor is selling substantially all of its assets or major assets.[341]

Sales of oil and gas assets can be either inside or outside of the ordinary course of business.[342] The Debtor's business judgment is the test for approval of a sale.[343] Thus, under Bankruptcy Code § 363, providing a transparent marketing process is useful because it helps to support the Debtor's business judgment. The Bankruptcy Code § 363 sale process to obtain approval of a sale of the Debtor's assets is typically subject to higher or better offers pursuant to a marketing process and auction. There is potential to obtain approval of a stalking horse with a break-up fee to ensure a minimum bid and a floor. No-shop type agreements with a buyer are generally not favored given the debtor's fiduciary duty, but there may be a short "go dark" period prior to the formal commencement of the marketing process. When appropriate, a debtor seeks court approval of bidding procedures that can include a minimum bid and minimum bidding increment, deposit and evidence of financial ability to consummate a sale, due diligence provisions and access/confidentiality

336. *See supra* Part II.A.

337. *See* FED. R. BANKR. P. 2002(a)(2), 6006(a), 6006(c) (2010).

338. 11 U.S.C. § 363(k).

339. Final Order (A) Approving the Sale of Certain of the Debtor's Assets Free and Clear of Claims and Liens and (B) Approving the Assumption and Assignment of Contracts and Leases, ATP Oil & Gas, No. 12-36187 (Bankr. S.D. Tex. Oct. 17, 2013).

340. *See generally* Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J.L. BUS. & FIN. 258 (2012).

341. *In re* Gulf Coast Oil Corp., 404 B.R. 407, 416 (Bankr. S.D. Tex. 2009) (citing Pension Benefit Guar. Corp., Cont'l Air v. Lines, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983)).

342. 11 U.S.C. § 363(b)(1), (c)(1).

343. *See, e.g.*, Institutional Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. *(In re* Cont'l Air Lines Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986) ("[F]or a debtor-in-possession or trustee to satisfy its fiduciary duty to the debtor, creditors and equity holders, there must be some articulated business justification for using, selling, or leasing the property outside the ordinary course of business.").

agreements, requirements of a qualified bid, procedures for designating assets and for assumption and assignment of contracts, and notice procedures, including potential publication notice. Some sales procedures have also included procedures regarding preferential rights to purchase, consent rights, and rights of first refusal.

A Bankruptcy Code § 363 sale often involves numerous negotiated provisions including those summarized below:

a) purchase price adjustments;

   i. receivables and production;

   ii. exclusion of property for title/environmental;

   iii. assumed liabilities and payables;

   iv. JOA prepayments, suspense funds, deposits;

b) pre-closing covenants;

   i. maintenance of oil and gas assets;

   ii. authorizations for expenditures (AFEs) and well elections;

   iii. capital Expenditures;

   iv. property access;

   v. indemnity by the potential buyer for liabilities caused by buyer as part of its diligence;

c) title;

   i. scope of title representations;

   ii. bankruptcy Code will not fix defects in title or ownership;

   iii. title diligence, defect mechanics, and hold-backs;

d) environmental;

   i. scope of environmental diligence;

   ii. certain environmental liabilities are inherent in ownership of property;

iii. defect mechanics and holdbacks;

e) preferential rights to purchase/rights of first refusal/consent rights;

i. different views as to enforceability in bankruptcy;

ii. mechanics to address any enforceable rights;

f) anti-survival clause;

i. representations and warranties typically do not survive closing;

ii. typically no post-closing indemnity for breach of representations and warranties unless limited to a cash holdback;

g) dispute mechanics;

i. optional arbitration of technical title, environmental, or accounting matters;

ii. bankruptcy court resolution for other disputes.[344]

Adequate protection is required in any free and clear sale.[345] The Debtor has the burden of proof on adequate protection, but the entity asserting an interest has the burden of proof regarding their interest in the property to be sold.[346] Interests often attach to proceeds with the same extent, validity, and priority in the assets prior to sale. Valuation takes a central role in determining adequate protection.[347] The courts have trended toward using a fair market valuation approach.[348]

1. Assumption of Executory Contracts and Unexpired Leases

In addition to satisfying the requirements of Bankruptcy Code § 363 with

344. *See In re Gulf Coast*, 404 B.R. at 420 ("The § 363 process ordinarily involves a chapter 11 debtor/seller and a prospective buyer presenting a fully negotiated asset purchase agreement (APA) to the bankruptcy court for approval.").

345. 11 U.S.C. § 363(e).

346. 11 U.S.C. § 363(p).

347. *In re* Waverly Textile Processing, Inc., 214 B.R. 476, 479 (Bankr. E.D. Va. 1997) (holding that the date the creditor filed the motion for adequate protection is the proper date for valuing the collateral for adequate protection purposes).

348. *See* Bank of N.Y. Trust Co. NA v. Pac. Lumber Co. (*In re* Scopac), 624 F.3d 274, 286 (5th Cir. 2010) *opinion modified on denial of reh'g*, 649 F.3d 320 (5th Cir. 2011); Salyer v. SK Foods, L.P. (*In re* SK Foods, L.P.), No. CIV. S-10-3467 LKK, 2011 WL 2709648, at *8 (E.D. Cal. July 11, 2011) (citing United Sav. Ass'n v. Timbers of Inwood, 484 U.S. 365 (1988)); Bank R.I. v. Pawtuxet Valley Prescription & Surgical Ctr., 386 B.R. 1, 3–4 (D.R.I. 2008) (interpreting Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (*In re* Winthrop Old Farm Nurseries), 50 F.3d 72, 73–74 (1st Cir. 1995)).

respect to oil and gas assets, buyers often wish to take assignment of executory contracts and unexpired leases that may be subject to Bankruptcy Code § 365. Bankruptcy Code § 365 authorizes the Debtor to assume or reject executory contracts and unexpired leases but requires the Debtor to cure certain defaults before assumption and to provide adequate assurance of future performance of contracts or leases.[349] The Bankruptcy Code permits the assignment of executory contracts and unexpired leases notwithstanding contractual provisions that might otherwise limit assumption or assignment.[350]

Numerous issues relating to assumption of executory contracts must be negotiated in connection with an oil and gas sale, including whether the cure will be paid by the buyer or the Debtor, if cure amounts are owed in connection with JOAs for operated wells relating to M&M liens and production revenues, and if cure amounts are owed under JOAs for non-operated wells for joint interest billings and failure to make elections regarding AFEs. Cure of defaults may require that the parties pay the M&M liens relating to a JOA if the JOA requires that the operator keep the contract area free and clear of liens. Such a requirement is often not asserted by counterparties when the M&M lien does not encumber their interests, but in states such as Oklahoma, where non-operator working interests are subject to M&M liens, these liens may need to be paid to cure defaults.[351] Additionally, parties often need to become current on payment of JIBs for assumption of a JOA.[352] As previously discussed, oil and gas leases may be subject to Bankruptcy Code § 365 in a few jurisdictions, which would require cure of defaults in order for the Debtor to assume them.

In the oil and gas industry, the sale of assets may also contemplate the disclosure of confidential and proprietary information to a buyer of assets. Courts have consistently held that Bankruptcy Code § 365(c) forbids the forced assignment of executory contracts involving intellectual property that contain anti-assignment provisions, as these assignments[353] are protected under federal copyright, trademark, and patent laws.[354] However, this protection is strictly construed. For example, the Eastern District of Louisiana, in an alternative ruling after allowing the assumption of a contract involving confidential seismic information, recently found that seismic information was a "trade secret," not intellectual property, and was not protected under Bankruptcy Code

349. 11 U.S.C. § 365(b).

350. 11 U.S.C. § 365(f).

351. OKLA. ST. tit. 42, §§ 141, 180 (2011).

352. *In re* Redwine Res., Inc., 2010 Bankr. LEXIS 6075, *44–46 (Bankr. N.D. Tex. Sept. 17, 2010).

353. A majority of courts additionally forbid the assumption of contracts by a debtor that contain anti-assignment language and are protected by intellectual property law. *See, e.g.*, RCI Tech. Corp. v. Sunterra Corp. (*In re* Sunterra Corp.), 361 F.3d 257, 262 (4th Cir. 2004). However, the Eastern District of Louisiana has ruled that the Fifth Circuit would only forbid assignment or an assumption that is meant to be an assignment. *In re* Virgin Offshore USA, Inc., No. CIV.A. 13-79, 2013 WL 4854312, at *4–5 (E.D. La. Sept. 10, 2013). Additionally, Justice Kennedy, in a denial of certiorari, has noted that he hopes the Supreme Court will settle the issue in the near future. *See* N.C.P. Mktg. Grp., Inc. v. BG Star Prods., 556 U.S. 1145, 1147 (2009).

354. *See, e.g.*, *In re* Golden Books Family Entm't, Inc., 269 B.R. 300, 310 (Bankr. D. Del. 2001).

§ 365(c).[355] Still, the court left open whether a party could prevent seismic data from falling into different hands through an assignment in a sale if the party potentially moved to copyright the seismic data as it would an artistic photograph.[356]

2. Bankruptcy Code § 363(h) and Partitioning

Bankruptcy Code § 363(h) allows a bankruptcy estate in certain circumstances to sell co-owned assets (including the interests of the co-owner) without consent of the co-owner if the co-owner is compensated with their share of the proceeds.[357] Bankruptcy Code § 363(i) gives the co-owner a statutory right of first refusal.[358] However, Bankruptcy Code § 363(h)(4) forbids a debtor in possession or trustee from selling a joint interest in property used in the production, transmission, or distribution for sale of electric energy or of natural or synthetic gas for heat, light, or power.[359] This provision has not been substantively interpreted by any court, but may be a protection available to parties that co-own energy or natural gas interests from having their property sold without their consent. An adversary proceeding is also required under Bankruptcy Rule 7001 to sell a co-owner's interests in assets.[360]

3. Rights of First Refusal and Preferential Rights to Purchase

In the upstream industry, many contracts, including many JOAs, may include rights of first refusal or other preferential rights that may be triggered by a proposed sale of the assets.[361] Bankruptcy Code § 365(f)(1) allows for the estate to void (although with the court's discretion)[362] preferential rights to purchase contained in an executory contract or unexpired lease.[363] For states such as Kansas in which an oil and gas lease is subject to Bankruptcy Code § 365, the sale of mineral interests might proceed according to Bankruptcy Code § 365(f)(1) in spite of preferential rights to purchase.

However, many oil and gas leases in the United States are classified as real property interests, thus these interests may not be considered executory contracts or unexpired leases subject to Bankruptcy Code § 365.[364] One of the open issues in bankruptcy law, however, concerns whether these preferential rights to purchase or rights of first refusal are executory contracts by

355. *In re Virgin Offshore*, 2013 WL 4854312, at *3–4 (citing Musser Davis Land Co. v. Union Pac. Res., 201 F.3d 561, 569–70 (5th Cir. 2001)).
356. *Id.*
357. 11 U.S.C. § 363(h) (2012).
358. *Id* § 363(h)–(i).
359. *Id.* § 363(h)(4).
360. FED. R. BANKR. 7001(3).
361. *See* Grochocinski v. Crossman (*In re* Crossman), 259 B.R. 301, 306–307 (Bankr. N.D. Ill. 2001).
362. *See* E-Z Serve Convenience Stores Inc., 289 B.R. 45, 52–54 (Bankr. M.D.N.C. 2003) (finding that it could void preferential right to purchase, but refused to do so for public policy reasons).
363. 11 U.S.C. § 365(f)(1).
364. *In re* J.H. Land & Cattle Co., Inc., 8 B.R. 237, 239 (Bankr. W.D. Okla. 1981).

themselves that a debtor may reject if burdensome to the estate.[365] In oil and gas bankruptcies, where a sale might be impacted by preferential rights to purchase of a third party that, outside of bankruptcy, would be able to substitute itself as a purchaser in a sale, the enforceability of these preferential rights is a major issue.[366]

An analogy can be made between a preferential right to purchase or right of first refusal and an option to purchase.[367] Most courts hold that an option is executory until it is exercised.[368] However, some courts, including the Ninth Circuit, have held that the option ceases to be executory when the option holder pays the purchase price.[369] The question becomes further complicated when taking into account what the holder needs to do in order to exercise the option. If the holder must tender further consideration or take other tangible steps beyond merely signing a document or giving notice, then courts might be more likely to view the contract as executory.[370] By analogy to an option, the preferential right to purchase may be unenforceable if the agreement containing the preferential right is rejected.

Parties may argue that the recording of the contract containing the right of first refusal makes it a covenant running with the land and thus not subject to rejection. However, some courts have held that the recordation of an option, even if it concerns real property, will not convert the option into a real property interest that is immune from rejection.[371] This question hinges to some extent on state law, and states such as Virginia have enacted statutes holding that the recording of a preferential right to purchase will elevate the preference right to a real property right.[372] Thus, preferential rights and rights of first refusal, so

365. *In re* Riodizio, Inc., 204 B.R. 417, 422–424 (Bankr. S.D.N.Y. 1997) ("The case law confirms that executoriness [of option contracts] lies in the eyes of the beholder.").

366. That is, assuming the rights are valid under state law, such as not being an absolute restriction on alienation. *See generally*, Wildenstein & Co. v. Wallis, 595 N.E.2d 828 (N.Y. 1992).

367. ConocoPhillips Co. v. Dahlberg, No. CIV.A. C-10-285, 2011 WL 710604, at *1 n.2 (S.D. Tex. Feb. 22, 2011) ("A 'preferential right, also known as a right of first refusal or preemptive right, is a right granted to a party giving him or her the first opportunity to purchase property if the owner decides to sell it. . . . [W]hen the property owner gives notice of his intent to sell, the preferential right matures . . . into an enforceable option.'") (quoting FWT, Inc. v. Haskin Wallace Mason Property Management, L.L.P., 301 S.W.3d 787, 793 (Tex.App.—Fort Worth 2009, pet. denied)).

368. *In re* Riodizio, Inc., 204 B.R. 417, 423 (Bankr. S.D.N.Y. 1997) ("Most courts . . . consider an option contract to be executory although they reach their conclusions through different routes."); *In re* Kellstrom Indus., 286 B.R. 833, 834–835 (Bankr. D. Del. 2002).

369. Unsecured Creditor's Comm. v. Southmark Corp. (*In re* Robert L. Helms Constr. & Dev. Co., Inc.), 139 F.3d 702, 706 (9th Cir. 1998) ("Performance due only if the optionee chooses at his discretion to exercise the option doesn't count [for executory contract analysis] unless he has chosen to exercise it.").

370. *In re* Abitibibowater, Inc., 418 B.R. 815, 830–31 (Bankr. D. Del. 2009) (noting that "[n]umerous other courts have determined that contingent option agreements are executory when material obligations will arise on each side if the option is exercised").

371. *In re* Jackson Brewing Co., 567 F.2d 618 (5th Cir. 1978) (recorded option rejectable); *In re* A.J. Lane & Co., 107 B.R. 435, 438 (Bankr. D. Mass. 1989) (noting that the option "is only a contract right—the right to purchase—whose remedy is normally specific performance [and t]hat the world is given notice of this right though its appearance in a recorded deed prevents any other buyer from claiming the equities of an innocent third party, but that is all").

372. *In re* Plascencia, 354 B.R. 774, 780 (Bankr. E.D. Va. 2006) ("Virginia . . . has changed the

common in oil and gas agreements, can present complex issues in sales under Bankruptcy Code § 363.

M. Synthetic Plan Sales

Sales of oil and gas assets can also be effectuated through a plan of reorganization, which is similar to an asset sale under Bankruptcy Code § 363 but provides more transactional flexibility. It is possible through such a synthetic plan sale to vest properties of the bankruptcy estate free and clear of liens, claims, encumbrances, and interests in the reorganized debtor with equity in the reorganized debtor issued to the purchaser, and with non-purchased assets, liabilities, and claims transferred to a liquidating trust.[373] Alternatively, the Debtor can be merged with an acquiring entity.[374] In these structures, the discharge and plan injunction prohibits creditors from pursuing claims against the buyer or the reorganized debtor as owned by the buyer.[375]

The benefit of a synthetic plan sale structure is that it often does not trigger preferential rights to purchase, consent rights, or rights of first refusal if structured as an equity sale or merger transaction.[376] Additionally, there is more flexibility to use securities as part of the consideration for the sale because of the Bankruptcy Code § 1145 securities registration exemption[377] or to use merger-type transaction structures.[378] Because the securities registration exemption is available under § 1145 to exchange securities of the Debtor or a successor to the Debtor principally for claims against the Debtor,[379] often a third-party buyer who does not have claims against the Debtor will rely on an otherwise applicable non-bankruptcy securities exemption, such as a private placement, for its purchase of securities from the Debtor. The § 1145 exemption may still be used in such circumstances to issue securities of the Debtor to creditors as part of their plan treatment.[380]

A synthetic plan sale must meet the voting and plan confirmation requirements of the Bankruptcy Code.[381] This means that creditors will have the right to disclosure and the plan voting and confirmation processes not present under a Bankruptcy Code § 363 sale. Requirements that need to be met for confirmation of a synthetic plan sale include each of the requirements for

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traditional rule, so that an option is in the 'nature of an interest in real estate which may be recorded and by that recordation protect the optionee's interest in the real estate.'") (quoting Springfield Eng'g Corp. v. Three Score Dev. Corp., 26 Va. Cir. 186, 191 (1992)).

373. 11 U.S.C. § 1123(a)(5)(B), (a)(5)(D), (b)(3)(B) (2014).

374. *Id.* § 1123(a)(5)(C).

375. *Id.* § 1141.

376. It is important, however, to review the applicable contracts and leases to determine the triggers of any preferential rights to purchase, consent rights, or rights of first refusal.

377. 11 U.S.C. §§ 1123(a)(5)(J), 1145.

378. *Id.* § 1123(a)(5)(C).

379. *Id.* § 1145(a)(1)–(2).

380. *Id.* § 1126 (addressing reorganization voting requirements); *Id.* § 1129(a) (addressing reorganization confirmation requirements).

381. *Id.* § 1129(a).

confirmation of the plan of reorganization set forth hereinabove.[382] Such requirements protect creditors in light of the greater flexibility and powers provided to the Debtor through the synthetic sale process.

IV. MIDSTREAM

Midstream companies typically engage in some combination of gathering, processing, storage, and transportation of hydrocarbons. Because the midstream industry is often described as the process of delivering oil and gas from the wellhead to refiners,[383] transportation is the most significant activity within the midstream sector. While oil and gas may be transported across geographic lines and boundaries through any number of means—such as rails, trucks, and barges—the most common and efficient method is by pipeline, and thus the largest companies and issues in the midstream industry tend to center around pipelines.

A. First Purchasers and SemCrude

The "first purchaser" of oil and gas produced is an integral player in the midstream industry. This first purchaser is most often a midstream entity that acquires the oil or gas so that it might resell it to a downstream party or transport and refine the oil or gas itself before moving it on to the consumer.[384] First purchasers often enter into large scale contracts with producers (such as E&P companies), whereby a producer risks the financial returns of any given project on the first purchaser's ability and willingness to pay for the oil or gas that is produced from the ground and loaded into a truck, tank, or pipeline. In order to mitigate the risks of non-payment to producers and royalty owners, numerous states have enacted first purchaser lien statutes whereby a producer or royalty owner has a statutory lien against the oil and gas (and sometimes accounts, chattel, inventory, etc.) transferred to a first purchaser until the producer or royalty holder is paid for such oil and gas.[385]

As of this writing, the following states have such liens: Texas, Kansas, Oklahoma, Mississippi, North Dakota, and New Mexico.[386] These statutes have remained largely untested with the exception of rulings in the *SemCrude* case.[387] SemCrude was a large private midstream company that filed for

382. See *supra* Part II.K.

383. CHARLOTTE J. WRIGHT & REBECCA A. GALLUM, INTERNATIONAL PETROLEUM ACCOUNTING 155 (2005).

384. A "first purchaser," in Texas, is defined as "the first person that purchases oil or gas production from an operator or interest owner after the production is severed, or an operator that receives production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement authenticated by the operator under which the operator collects proceeds of production on behalf of other interest owners." TEX. BUS. & COMM. CODE ANN. § 9.343(r)(3) (2002). An "operator" is "a person engaged in the business of severing oil or gas production from the ground, whether for the person alone, only for other persons, or for the person and others." *Id.* at § 9.343(r)(4).

385. *See, e.g.*, TEX. BUS. & COMM. CODE ANN. § 9.343 (West 2011).

386. *See infra* Appendix C, for a fifty-state survey of first purchaser and royalty liens.

387. Arrow Oil & Gas, Inc. v. SemCrude, L.P. (*In re* SemCrude, L.P.), 407 B.R. 112 (Bankr. D.

bankruptcy in 2008.[388] In that case, producers that sold oil to the Debtor litigated with the Debtor's secured lenders over the issue of whose liens had first priority in the oil and gas proceeds.[389]

The Delaware Bankruptcy Court held for the priority of banks' interests[390] over Kansas lien holders.[391] Kansas had a similar statute to Texas that automatically perfected security interests for oil and gas production for an indefinite amount of time.[392] However, the court examined Kansas' version of the UCC to find that the interest holders had an indefinite security interest but did not have automatic priority,[393] as Oklahoma and Delaware law applied regarding perfection.[394] So, only if individual Kansas parties had perfected security interests appropriately under Delaware or Oklahoma law (which did not include automatic perfection) before other parties would the royalty holder, as a first filer, take priority.[395]

The Court held likewise for parties holding security interests under Texas's royalty security interest statute.[396] The court held in part that the Texas Uniform Commercial Code did not govern perfection and priority of the producer's liens under conflict of law rules because the Debtors were Delaware or Oklahoma entities, and the producers would only have priority to the extent that they were perfected before the banks by filing a financing statement under Delaware or Oklahoma law.[397] The royalty owner's security interest statute in Texas is a non-standard UCC provision that had not been enacted in Delaware or Oklahoma, and Delaware and Oklahoma did not have the automatic perfection right.[398]

Oklahoma, after *SemCrude*, enacted the Oil and Gas Owners' Lien Act of 2010,[399] which is a relatively new and untested statute that is not part of their enacted Uniform Commercial Code.[400] This statute states that:

> An oil and gas lien is granted and exists as part of an incident to the ownership of oil and gas rights and is perfected automatically without

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Del. 2009).

388. *Id.* at 118.

389. *Id.* at 123–125.

390. Landowners also may mortgage their mineral rights in certain jurisdictions, which mortgages may extend to proceeds of the hydrocarbons. Jones v. Salem Nat'l Bank (*In re* Fullop), 6 F.3d 422, 428–30 (7th Cir. 1993).

391. Mull Drilling Co. v. SemCrude, L.P. (*In re* SemCrude, L.P.), 407 B.R. 82, 88 (Bankr. D. Del. 2009).

392. K.S.A. § 84-9-339a (1996).

393. *In re SemCrude*, 407 B.R. at 102.

394. *Id.* at 110.

395. *Id.* at 103.

396. *See* Arrow Oil & Gas, Inc. v. SemCrude, L.P. (*In re* SemCrude, L.P.), 407 B.R. 112, 129–130 (Bankr. D. Del. 2009).

397. *Id.* at 137.

398. *Id.* at 132.

399. OKLA. STAT. tit. 52, § 549 *et seq* (2011).

400. Fred H. Miller & Alvin C. Harrell, *Aftermath of the SemCrude Case, Oklahoma Enacts the Oil and Gas Owners' Lien Act of 2010*, 81 OKLA. B. J. 2819 (Dec. 2010).

> the need to file a financing statement or any other type of documentation. An oil and gas lien exists and is perfected from the effective date of this act.[401]

Thus, Oklahoma explicitly granted royalty owners a lien from the inception of the statute. It also provides that, except for certain permitted liens, an oil and gas lien takes priority over any other lien, whether arising by contract, law, equity or otherwise, or any security interest.[402] "Permitted lien" is narrowly defined in the statute and does not include typical finance liens that first purchaser liens compete against.[403] Though this lien is not enforceable against a bona fide purchaser from the first purchaser, it attaches to proceeds received by the first purchaser.[404] Importantly, Oklahoma forbids royalty owners from waiving their statutory lien, so as to prevent the waiver of the liens becoming industry standard.[405] Like the Texas statute, the Oklahoma lien exists in identifiable collateral and proceeds until the interest owner has been paid.[406]

B. Easements and Rights of Way

The distances covered by pipelines regularly require midstream companies to negotiate right of ways and easements with the owners of the land that pipelines must cross to reach their final destination. In turn, these right of ways and easements become valuable property interests of a midstream company. An estate must meet the requirements of Bankruptcy Code § 363 to sell easements.[407] For example, one court refused to approve the sale of a pipeline easement as it did not provide an adequate return and protection for entities that held a security interest in the pipeline easement and unfairly put the interests of the Debtor ahead of secured creditors.[408]

Notably, a party that acquires a security interest in a pipeline should also take heed to perfect its interest in both real and personal property. This is because a pipeline easement, governed by state law, may be a bifurcated property right with the land being a real property right, but the pipeline possibly classified as a personal property interest. This depends on, among other factors, whether the parties intended to keep the pipeline on the property indefinitely or whether the pipeline was placed with the intent to benefit the purpose of trade and not to enhance the land.[409] Easements may also be

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401. OKLA. STAT. tit. 52, § 549.4.

402. *Id.* § 549.7.

403. *Id.* § 549.2(11)(b) (a permitted lien is a "validly perfected and enforceable lien created by statute or by rule or by regulation of a governmental agency for storage or transportation charges . . . owed by a first purchaser in relation to oil or gas originally purchased under an agreement to sell").

404. *Id.* § 549.6.

405. *Id.* § 549.2(11)(b).

406. *Id.* § 549.3(B).

407. 11 U.S.C. § 363 (2012).

408. *In re* Mulberry Corp., 265 B.R. 468, 468–469 (Bankr. M.D. Fla. 2001).

409. *See, e.g.*, Dorchester Master Ltd. P'ship v. Dorchester Hugoton, Ltd., 914 S.W.2d 696, 704 (Tex. App.—Corpus Christi 1996, writ granted w.r.m.); Tex. Att'y Gen. Op. No. DM-438 (May 2,

avoided pursuant to Bankruptcy Code § 544 if the easement burdens a property and is not properly recorded, even though the easement is an interest in real property.[410]

C. Gas Purchase Agreements and Tri-Party Netting

A gas purchase agreement is an agreement by one party to purchase gas from another.[411] Gas purchase agreements often are between upstream and midstream parties, whereby the midstream entities enter into agreements laying out the price and terms to purchase gas from producers.[412] Typically, these contracts contemplate a long term or even indefinite continuance of performance by the parties, and they are typically executory contracts that may be rejected in the event of a bankruptcy.[413] In the event they are not rejected and are assumed, the estate must make the other contracting party whole by paying all "cure" costs under the contract.[414]

Parties to gas purchase agreements often include language that allows them to net-out mutual obligations by offsetting debts. For example, if Producer was owed X dollars from its contract with Midstream Inc. under one contract, and Midstream Co. was owed Y dollars from Producer in another contract, then, in the event of a bankruptcy by Midstream Co., Producer could seek to offset "X" amount of dollars through a state law setoff remedy after getting relief from the automatic stay to do so.[415] Midstream companies often take this arrangement a step farther by instituting "tri-party netting" whereby entities can also offset debts from their counterparty's "affiliates."[416] This raises the issue whether these debts are truly "mutual" as is required under the setoff provisions of Bankruptcy Code § 553.

In *SemCrude*, Chevron had numerous contracts with the Debtors that provided it could "net-out" obligations owed to it by the Debtors' affiliates from obligations to the Debtors themselves.[417] The court stated from the outset that it would not allow triangular setoffs in the midstream or any other context, as "allowing a creditor to offset a debt it owes to one corporation against funds

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1997).

410. Probasco v. Eads (*In re* Probasco), 839 F.2d 1352, 1354 (9th Cir. 1988) (discussing 11 U.S.C. § 544).

411. *See* 61 AM. JUR. 2D PIPELINES § 5 (2014).

412. *See, e.g.*, Paragon Res., Inc. v. Nat'l Fuel Gas Distrib. Corp., 695 F.2d 991 (5th Cir. 1983) (enforcing a gas purchase agreement between an upstream natural gas producer and a midstream natural gas distributor).

413. Manus Corp. v. NRG Energy, Inc. (*In re* O'Brien Envtl. Energy, Inc.), 188 F.3d 116, 118–119 (3d Cir. 1999); BP Energy Co. v. Bethlehem Steel Corp., No. 02 CIV. 6419 (NRB), 2002 WL 31548723, at *1 (S.D.N.Y. Nov. 15, 2002).

414. 11 U.S.C. § 365 (2014).

415. This is in contrast to parties in derivatives contracts that will most likely be immune from the restrictions of the automatic stay. 11 U.S.C. §§ 546, 560.

416. *See In re* Garden Ridge Corp., 338 B.R. 627, 633 (Bankr. D. Del. 2006), *aff'd*, 399 B.R. 135 (D. Del. 2008), *aff'd*, 386 F. App'x 41 (3d Cir. 2010).

417. *In re* SemCrude, L.P., 399 B.R. 388, 392 (Bankr. D. Del. 2009), *aff'd*, 428 B.R. 590 (D. Del. 2010).

owed to it by another corporation—even a wholly-owned subsidiary—would thus constitute an improper triangular setoff under the Code."[418] Even though Chevron did business with three related SemCrude entities, it could not offset debts via its master netting agreement in bankruptcy, even if it could do so under state law, as there were no exceptions under the Bankruptcy Code for this proposition.[419]

418. *Id*. at 393–94.

419. *Id.* at 398; *see* also *In re* Eng. Motor Co., 426 B.R. 178, 189 (Bankr. N.D. Miss. 2010) (citing *In re Semcrude*, 399 B.R. 388); *In re* Lehman Bros., 458 B.R. 134, 142 (Bankr. S.D.N.Y. 2011) ("The careful analysis in *SemCrude* is persuasive. There simply is no contract exception to section 553(a), because the statute itself does not allow for one.").

V. DOWNSTREAM

The term "downstream" in the oil and gas industry applies to the final points of oil and gas production before delivery to customers.[420] Downstream industry participants can occupy different and often overlapping roles, with the most common being refiners, retailers, traders, and marketers.

A. Refining and LyondellBassell

Refiners handle hydrocarbons during their earliest point downstream, collecting them immediately after transport from midstream parties to reduce, through chemical processes, the hydrocarbons from a raw state to one that can be efficiently and safely used by consumers. The primary entities in the refining sector, due to the infrastructure and knowledge needed to succeed, are large, sophisticated entities. Thus, complex cases arise when refiners file for bankruptcy, such as the case of LyondellBassell.

LyondellBassell was the product of a transatlantic merger in 2007 between refiners and was an industry leader before its filing.[421] LyondellBassell refined multiple types of hydrocarbons, including, but not limited to, heavy and high sulfur crude in the United States and medium weight crude in France.[422] LyondellBassell faced an emergency situation (and need for emergency capital) paired with the frantic mood in the credit markets, with lenders unwilling to forgive or take on risk in the heart of the 2008-2009 financial crash.[423] Topping this off was the perfectly ill-timed Hurricane Ike, which greatly disrupted LyondellBassell's operations in the Houston area.[424] Therefore, the "immediate cause of the filing of the Chapter 11 [case] on January 6, 2009 [by LyondellBassell] was a sudden loss of liquidity."[425]

LyondellBassell was able to obtain post-petition financing of up to $8.5 billion on the first day of its case and pushed forward immediately with a Chapter 11 plan of reorganization.[426] LyondellBassell used Bankruptcy Code § 365 powers to shed employees and onerous obligations, enter into agreements with its major lenders to pay off necessary debts with new secured loans and equity shares in the reorganized company, and cancel its existing equity shares.[427] LyondellBassell's plan of reorganization was confirmed, and the reorganized company still operates out of many of its historic facilities. Its bankruptcy demonstrates that Chapter 11 can be an effective mechanism to

420. *See Glossary of Energy Terms*, SPECTRA ENERGY, http://www.spectraenergy.com/ Natural-Gas-101/Glossary-of-Energy-Terms/D/ (last visited Oct. 30, 2014).

421. Third Amended Disclosure Statement Accompanying Third Amended Joint Chapter 11 Plan of Reorganization for the LyondellBasell Debtors at 25, *In re* Lyondell Chemical Co., No. 09-10023 (Bankr. S.D.N.Y. 2010).

422. *Id.* at *25–31.

423. *Id.* at *39.

424. *Id.*

425. *Id.* at *38.

426. *Id.* at *38, *45.

427. *Id.* at *113.

weather drastic market swings or catastrophic events in the refinery segment.

B. Retail: Flying J

Oil and gas's most public connection to the market is the retail sector. After the tasks of exploring, producing, shipping, and refining the hydrocarbons, the value derived from the oil and gas is still dependent on whether or not end users will purchase the hydrocarbons. Oil and gas retailers thus play an integral part in the industry, but are uniquely exposed to market risks as direct sellers of the refined products to consumer parties. In retail bankruptcies, such as with Flying J, the company often cannot sell enough goods to keep up with its obligations.[428]

Before filing, Flying J was a very large company with a heavy downstream presence, with the most visible being its gas stations.[429] As a seller to end users, Flying J was especially vulnerable to the fragilities of the collective economy. Flying J management blamed the bankruptcy on the company's strategy that caused the company to grow too fast and too large with a goal of revenue coming before profits.[430] Flying J emerged from bankruptcy leaner, laying off employees and using the Bankruptcy Code's broad rejection and sale powers to discard obligations that were not key to its downstream focus, with the largest move being the selling of its Bakersfield refinery and the bulk of its midstream business, Longhorn Pipeline (Longhorn).[431] Flying J cancelled existing equity interests and sold new ones to Pilot Travel Centers (Pilot), a retail competitor, and achieved confirmation of its plan of reorganization by offering cash to pay off major creditors generated through the Bakersfield and Longhorn sales, along with financing and a merger with Pilot.[432] This merger and more narrow focus allowed Flying J to successfully emerge from the Chapter 11 process.

C. Ethanol

Backed by government subsidies and incentives, a boom of companies and technologies emerged in order to cash in on the new frontier of ethanol, which had emerged as a potential fuel alternative. Given competition by advances in extracting traditional energy sources such as fracking, ethanol has not become a true contender with fossil fuels.[433] Further, periods of diminished spreads

428. Disclosure Statement at 14, *In re* Flying J, Case No. 08-13384 (Bankr. D. Del. 2010), ECF No. 3655.

429. *Id.*

430. Paul Beebe, *Flying J's bankruptcy a tale of rapid growth without corresponding profit*, SALT LAKE TRIBUNE (Aug. 7, 2009), http://www.sltrib.com/business/ci_13016785.

431. Disclosure Statement at 29, *In re* Flying J, Case No. 08-13384 (Bankr. D. Del. 2010), ECF No. 3655.

432. *Id.* at *30–34.

433. *Compare*, Alexei Barrionuevo, *Boom in Ethanol Reshapes Economy of Heartland*, N.Y. TIMES (Jun. 25, 2006), http://www.nytimes.com/2006/06/25/business/25ethanol.html? pagewanted=all&_r=0, *with* Clifford Krauss, *Ethanol's Boom Stalling as Glut Depresses Price*, N.Y. TIMES (Sep. 30, 2007),

between corn feedstock costs and ethanol sale prices, commonly referred to as the crush margin, have caused ethanol plants to file for bankruptcy protection.[434] These bankruptcies occurred in a large swath of the United States, with the Midwest and agricultural belt of the United States taking on a prominent role due to the presence of the corn farming industry.[435] Ethanol plants also require complex equipment, commodity contracts, and improved real property. Indeed, some ethanol plant bankruptcies were not caused by the market but instead resulted from explosions at their plants.[436] The ethanol bankruptcies present issues similar to other energy industry bankruptcies, particularly refining.[437] In at least one case where a reorganization of an ethanol producer was not successful, secured creditors elected to mothball specialized ethanol collateral rather than continuing to refine.[438]

D. Trading and Marketing: MF Global

The bankruptcy of MF Global demonstrates the difference between those in the downstream industry that deal with the actual physical hydrocarbons and infrastructure from those that engage in trading markets for the hydrocarbons. Companies such as LyondellBassell and Flying J were better equipped to emerge from a crisis of liquidity due to their patents, physical assets, and contracts. Companies like MF Global in the derivatives business may be less likely to emerge intact from a Chapter 11 bankruptcy due to the immediate fragility that accompanies the filing of a company whose value is tied more to goodwill and relationships than physical assets. MF Global was a large financial firm in the business of trading securities and commodities, with a large part of its practice devoted to oil and gas futures.[439] MF Global collapsed due to risky[440] strategies and violations of industry and legal standards, notably the conversion of consumer accounts to cover trading losses and the failure to

http://www.nytimes.com/2007/09/30/business/30ethanol.html? pagewanted=print.

434. *See In re* Garden Ridge Corp., 338 B.R. 627, 633 (Bankr. D. Del. 2006), *aff'd*, 399 B.R. 135 (D. Del. 2008), *aff'd*, 386 F. App'x 41 (3d Cir. 2010).

435. *See, e.g.*, E3 Biofuels, LLC v. Biothane, LLC, 6 F. Supp. 3d 993, 995–99 (D. Neb. 2014); GOE Lima, LLC v. Ohio Farmers Ins. Co. (*In re* GOE Lima), No. 02 CIV. 6419 (NRB), 2012 WL 930289 (Bankr. N.D. Ohio 2012); Sherman v. Greenstone Farm Credit Servs., ACA, No. 3:11-CV-0710-N, 2011 WL 2038573, at *7–9 (N.D. Tex. May 24, 2011); *In re* Levelland Hockley Cnty. Ethanol, LLC, No. 11-05013 (Bankr. N.D. Tex. 2011), ECF No. 1 (adversary regarding the classification of government grant money given to debtors was filed and subsequently settled).

436. *See* Am. Prairie Constr. Co. v. Hoich, 560 F.3d 780 (8th Cir. 2009); *E3 Biofuels*, 6 F. Supp. 3d at 995.

437. *See* CHS, Inc. v. Plaquemines Holdings, LLC, 735 F.3d 231, 233–34 (5th Cir. 2013); *In re* W. Biomass Energy LLC, No. 12-21085, 2013 WL 4017147, at *1 (Bankr. D. Wyo. Aug. 6, 2013).

438. Sherman v. Greenstone Farm Credit Servs., ACA, No. 3:11-CV-0710-N, 2011 WL 2038573, at *2–3 (N.D. Tex. May 24, 2011).

439. Dina ElBoghdady, *Report on MG Global Faults Regulators*, WASH. POST (Nov. 15, 2012), http://www.washingtonpost.com/business/economy/report-on-mf-global-faults-regulators/2012/11/15/f8fd87b6-2f62-11e2-a30e-5ca76eeec857_story.html.

440. This risk extended beyond the oil and gas industry such as when an MF Global trader lost nearly all of MF Global's profit in 2008 when, trading on his own account, he placed a bad bet on wheat futures.

maintain adequate oversight of actions taken to limit the company's liquidity.[441] MF Global's creditors ranged from customers with trading accounts to a $1.2 billion revolving credit facility from JP Morgan.[442]

Like Lehmann Brothers, MF Global's physical assets were small compared to its debts ($11.3 billion of claims were filed against MF Global), and the main source of its value, its people and contacts, were migratory. Thus, MF Global demonstrated the hallmarks of a trading company failure: risky business strategies and inadequate controls.[443]

VI. ENERGY SERVICES

Energy services firms are important players in the energy industry. Energy service firms can include oilfield services companies, such as fracking companies, seismic firms, and oil rig contractors. Shipping companies also provide services to the energy industry by moving refined product.

A. Shipping

Often, oil and gas is produced across oceans from where it will be used. Thus, oil and gas needs to be transported in huge, complex, and expensive transport ships. For example, TMT Procurement Corp. (TMT), a conglomerate of oil and gas tankers and shippers, filed for bankruptcy in the summer of 2013.[444] Some of its ships were arrested in foreign ports under the authority of various bank and maritime liens in favor of parties deemed essential to servicing ships.[445]

The TMT bankruptcy demonstrated both the broad and limited powers of United States bankruptcy courts, from the court being called on to consider a motion to dismiss the case because of alleged illicit dealings of Iranian oil to the court's powers being limited regarding ships docked in foreign ports and subject to foreign liens.[446] The case ended up essentially falling into two major

441. *See generally* Report of Investigation of Louis J. Freeh, Chapter 11 Trustee of MF Global Holdings Ltd., *In re* MF Global Holdings LTD, No. 11-15059 (Bankr. S.D.N.Y. Apr. 4, 2013).

442. *Court Approves MF Global Bankruptcy Exit Plan*, CHI. TRIBUNE (Apr. 5, 2013) http://articles.chicagotribune.com/2013-04-05/business/chi-mf-global-bankruptcy-exit-plan-primed-for-court-hearing-20130405_1_trader-customers-cyrus-capital-partners-james-giddens.

443. Report of Investigation of Louis J. Freeh, Chapter 11 Trustee of MF Global Holdings Ltd. at 12, *In re* MF Global Holdings LTD, No. 11-15059 (Bankr. S.D.N.Y. Apr. 4, 2013) ("Although a difficult economic climate and other factors may have accelerated [MF Global's] failure, the risky business strategy engineered and executed by Corzine and other officers and their failure to improve the Company's inadequate systems and procedures so that the Company could accommodate that business strategy contributed to the [collapse].").

444. *In re* TMT Procurement Corp., No. 13-33763 (Bankr. S.D. Tex. 2013).

445. Amended Complaint to Compel Turnover and For Temporary and Permanent Injunctive Relief at 7–9, C Whale Corp. v. Active Tankers Shipmanagement S.A. (*In re* TMT USA Shipmanagement LLC), No. 13-03141 (Bankr. S.D. Tex. June 20, 2013), ECF No. 1.

446. Memorandum in Support of Cathay United Bank's Emergency Motion for Entry of an Order Dismissing the Debtor's Chapter 11 Cases Pursuant to 11 U.S.C §§ 105(a) and/or 1112(b) with Prejudice, or, in the Alternative, for Appointment of Trustee Pursuant to 11 U.S.C. § 1104(a)(1), *In re* TMT Procurement, No. 13-33763, (Bankr. S.D. Tex. Nov 1, 2013), ECF No. 647.

components: the reorganization of debts and sales of ships not arrested in foreign ports compared with ships arrested being dealt with by foreign jurisdictions.[447] The final outcome of TMT is yet to be accomplished.

The bankruptcy case of Overseas Shipholding Group Inc. (OSG) is another notable case involving an oil and gas-related shipping company.[448] OSG operated a fleet of vessels including crude oil tankers, product carriers of refined petroleum products, and U.S.-flagged barges.[449] OSG's Chapter 11 plan included a $1.5 billion rights offering that gave existing equity holders the right to purchase stock in reorganized OSG and was confirmed on July 18, 2014.[450] A significant reason for OSG's Chapter 11 filing was the potential for substantial tax liabilities.[451] In the bankruptcy case, the Internal Revenue Service filed forty-two separate proofs of claim against OSG asserting income tax liability of over $463 million, which was subsequently negotiated down to $255 million and was to be paid in full pursuant to OSG's Chapter 11 plan.[452]

B. Oilfield Services

The bankruptcies of *In re Green Field Energy Services*[453] and *In re Stallion Oilfield Services LTD*[454] are demonstrative of two different paths that oilfield services bankruptcies can take. In *Stallion*, the Debtor was a full service provider with a motto of "Everything but the Rig," demonstrating the breadth of its services.[455] However, faced with a credit crunch and declining financial fortunes of its natural gas producing customers, Stallion filed for bankruptcy protection.[456] Major stakeholders of the estate structured or supported a pre-arranged reorganization (with a proposed plan filed the first day of the case), which resulted in a quick reorganization of the company in Delaware.[457]

Green Field involved another multi-purpose oilfield service provider that included fracking services, well services, and a sand operations segment.[458] The Debtor, however, became vulnerable with one customer representing

447. *Id.*

448. *See Corporate Profile*, OVERSEAS SHIPHOLDING GRP., www2.osg.com/index.cfm? pageid=2 (last visited Oct. 30, 2014).

449. First Amended Disclosure Statement at 19–22, *In re* Overseas Shipholding Grp., Inc., No. 12-20000 (Bankr. D. Del. June 4, 2014), ECF No. 3339.

450. First Amended Plan of Reorganization, *In re* Overseas Shipholding Grp., Inc., No. 12-20000, ECF No. 3663.

451. First Amended Disclosure Statement at 19–22, *In re* Overseas Shipholding Grp., Inc., No. 12-20000 (Bankr. D. Del. June 4, 2014), ECF No. 3339.

452. *Id.*

453. *In re* Green Field Energy Servs., Inc., No. 13-12783 (Bankr. D. Del. 2013).

454. *In re* Stallion Oilfield Servs., LTD, No. 09-13562 BLS (Bankr. D. Del. 2009).

455. *Stallion Oilfield Services, Inc. IPO*, NASDAQ, http://www.nasdaq.com/markets/ipos/company/stallion-oilfield-services-inc-714092-54156 (last visited Oct. 30, 2014).

456. Disclosure Statement at 10, *In re* Stallion Oilfield Services LTD, No. 09-13562 BLS (Bankr. D. Del. Oct. 19, 2009), ECF No. 12.

457. Plan of Reorganization, *In re* Stallion Oilfield Services LTD, No. 09-13562 BLS (Bankr. D. Del. Oct. 19, 2009), ECF No. 13.

458. First Amended Disclosure Statement at 13, *In re* Green Field, No. 13-12783 (Bankr. D. Del. Mar. 6, 2014), ECF No. 663.

approximately 80% of the Debtor's business. When this customer cut back on its operations with the Debtor, the Debtor faced a severe credit crunch.[459] The Debtor filed for bankruptcy but was forced to effect a sale of its inventory with the secured lender being paid a fee for selling the assets while sharing in certain profits of the sale, and the estate retaining certain avoidance actions against the Debtor's principals.[460]

In the offshore services industry, the bankruptcy case of Trico Marine Services, Inc. (TMS) illustrates the utility of Chapter 11 to shed unprofitable and burdensome assets in the course of reorganization.[461] Prior to filing for bankruptcy, TMS and its related entities provided three types of services to primarily oil and natural gas exploration and production companies, including: (a) subsea services, (b) subsea trenching and protection services, and (c) towing and supply services and vessels.[462] TMS's bankruptcy generally included only TMS's towing and supply assets, which were sold throughout the bankruptcy case, but the Chapter 11 process also helped facilitate an out-of-court restructuring of TMS's subsea services assets via a settlement of intercompany claims.[463] TMS shed the burdensome legacy towing and supply entities, leaving a restructured company that included only the subsea services entities that were de-levered via an exchange offer.[464]

VII. POWER

The electric utility industry is among the most heavily regulated industries in the United States. A number of administrative agencies and commissions at the federal, state, and local level govern a broad spectrum of an electric utility's business, from rates to safety to environmental concerns. When an electric utility files for bankruptcy, these regulations may often conflict with the Bankruptcy Code and its aims to rehabilitate or provide for an organized dissolution of a bankrupt entity. While a myriad of issues may arise in the course of a bankruptcy case involving an electric utility (and attention to each of these issues would far exceed the scope of this Article), there are certain issues that uniquely impact an electric utility in bankruptcy.

A. Police and Regulatory Exception to the Automatic Stay

As discussed above, the "police and regulatory exception" of Bankruptcy Code § 362(b)(4) provides that certain actions by governmental units are not

459. First Amended Disclosure Statement at 13, *In re* Green Field, No. 13-12783 (Bankr. D. Del. Mar. 6, 2014), EFC 663.

460. *Id.* at 17, 26–28.

461. Salsberg v. Operators, Inc. (*In re* Trico Marine Servs., Inc.), 337 B.R. 811, 815–16 (Bankr. S.D.N.Y. 2006).

462. Second Amended Disclosure Statement at 1–2, *In re* Trico Marine Servs., Inc., No. 10-12653, (Bankr. D. Del. May 25, 2011), ECF No. 1283.

463. *Id.* at ECF No. 1283.

464. *Id.* at ECF No. 1283 at 24–25.

prohibited by the automatic stay.[465] The scope and applicability of this exception in the power context are illustrated by the case of *In re Pacific Gas & Electric Co. v. California Public Utilities Commission.*[466] In *Pacific Gas*, the Debtor, Pacific Gas & Electric Co. (PG&E) instituted an adversary proceeding seeking a preliminary injunction to prevent the California Public Utilities Commission (CPUC) from enforcing an order issued by CPUC.[467] Leading up to the bankruptcy filing by PG&E, the State of California enacted legislation that provided for the deregulation of electric utilities.[468] In order to "allow electrical corporations an opportunity to continue to recover certain transition costs," the legislators froze retail rates for a limited period, dependent, in part, upon the utility's ability to recover transition costs.[469] As a part of this process, CPUC established two types of accounts to distinguish transition costs from other operations, as well as to track the recovery of transition costs.[470] However, for months when operating costs exceeded revenues, the impact of these negative balances on the recovery of transition costs was ambiguous.[471] As a result, CPUC later issued an "Accounting Decision" that required negative balances to offset recovered amounts, thus prolonging the rate freeze.[472] The Accounting Decision also included an "interim order," which implemented this decision.[473] In bankruptcy, PG&E sought to stay this interim order.[474] In response, CPUC filed a motion to dismiss asserting multiple arguments, including an argument that the automatic stay of Bankruptcy Code § 362(a) was inapplicable to the Accounting Decision and the interim order due to the police and regulatory exception of § 362(b)(4).[475]

In its examination of whether the police and regulatory exception applied, the bankruptcy court assumed, without deciding, that the automatic stay applied pursuant to Bankruptcy Code §§ 362(a)(1) and (3).[476] Accordingly, the bankruptcy court focused its analysis entirely upon whether the police and regulatory exception applied to the Accounting Decision.[477] Current jurisprudence regarding this exception has elucidated two "tests" for determining whether governmental actions fit within the exception: the pecuniary purpose test and the public policy test.[478] If the governmental

465. 11 U.S.C. § 362(b)(4) (2012).
466. Pac. Gas & Elec. Co. v. Lynch (*In re* Pac. Gas & Elec. Co.), 263 B.R. 306, 310 (Bankr. N.D. Cal. 2001).
467. *Id.*
468. 1996 Cal. Legis. Serv. Ch. 854.
469. *In re Pac. Gas & Elec. Co*., 263 B.R. at 310.
470. *Id.* at 311 (internal quotation marks omitted).
471. *Id.*
472. *Id.*
473. *Id.* at 312.
474. *Id.*
475. *Id.* at 316–17.
476. *Id.* at 316.
477. *See id.* at 318.
478. *Id.* at 317 (citing N.L.R.B. v. Cont'l Hagen Corp., 932 F.2d 828, 833 (9th Cir. 1991)).

actions pass either test, then the police and regulatory exception applies.[479] Under the pecuniary purpose test, the court examines whether the government action relates primarily to the protection of the government's pecuniary interest in the Debtor's property or to matters of public safety and welfare.[480] The public policy test distinguishes between government actions that effectuate public policy and those that adjudicate private rights.[481]

Ultimately, the bankruptcy court found that both tests favored application of the exception. As to the pecuniary purpose test, the bankruptcy court found that the primary purpose of the Accounting Decision was to implement "an important public policy" in "rate-making."[482] Similarly, as to the public policy test, the bankruptcy court found that the decision is "more legislative in character" and was not adjudicating private rights (i.e., favoring consumers).[483] Moreover, the Accounting Decision stemmed from CPUC's rate-making authority and noted that regulation of utilities is "one of the most important of the functions traditionally associated with the police power."[484] The *Pacific Gas* decision provides governmental regulators of electric utilities an argument to enforce certain regulations notwithstanding the automatic stay. Specifically, regulations and administrative actions that fall within the rubric of a governmental unit's "rate-making" authority may not be barred by the automatic stay.

B. FERC vs. the Bankruptcy Court

Pursuant to the Federal Power Act, Congress granted the Federal Energy Regulatory Commission (FERC) authority over the interstate transmission and sale of electric energy.[485] This authority confers exclusive jurisdiction with FERC over the determination of whether wholesale electricity rates are "just and reasonable."[486] This exclusive authority has led to the creation of the "filed rate doctrine," which essentially holds that "the reasonableness of rates and agreements regulated by FERC may not be collaterally attacked in state or federal courts."[487] The only forum for challenging rates is before FERC or a federal court reviewing a FERC order.[488] Furthermore, a filed rate can only be changed if "the rate is so low as to adversely affect the public interest—as

479. Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633 (1990); N.L.R.B. v. Edward Cooper Painting, Inc., 804 F.2d 934, 942 (6th Cir. 1986).

480. Pac. Gas & Elec. Co. v. Lynch (*In re* Pac. Gas & Elec. Co.), 263 B.R. 306, 317 (Bankr. N.D. Cal. 2001).

481. *Edward Cooper Painting*, 804 F.2d at 942.

482. *In re Pac. Gas*, 263 B.R. at 318–19.

483. *Id.* at 319.

484. *Id.* at 320 (quoting Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n, 461 U.S. 375, 377 (1983) (internal quotation marks omitted).

485. *See* 16 U.S.C. § 824(a) (2012).

486. *Id.* § 824(d)(a); Miss. Power & Light Co. v. Miss. *ex rel.* Moore, 487 U.S. 354, 371–72 (1988).

487. Mirant Corp. v. Potomac Elec. Power Co. (*In re* Mirant Corp.), 378 F.3d 511, 518 (5th Cir. 2004) (internal quotation marks omitted).

488. *Id.*

where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."[489]

Federal district courts have original exclusive jurisdiction over all cases arising under the Bankruptcy Code as well as exclusive jurisdiction "of all property, wherever located, of the Debtor as of the commencement of such case, and of property of the estate."[490] Bankruptcy court jurisdiction, referred by the federal district court, and FERC jurisdiction have collided when an electric utility seeks to reject FERC-regulated power supply contracts. Three major cases have dealt with these issues, but the decisions in the cases do not provide clear guidance for debtors.

In the bankruptcy case of *NRG Energy, Inc.* (NRG Energy), the Debtor sought to reject a power supply agreement under which NRG Power Marketing (NRG) provided a fixed amount of electricity to Connecticut Light & Power (CLP) at a fixed price from January 1, 2000 to December 31, 2003.[491] Prior to the Chapter 11 filing of NRG Energy, CLP was informed that it was in default of certain amounts due under the power supply agreement.[492] Subsequently, NRG notified CLP that it intended to terminate the power supply agreement.[493] That same day, NRG Energy, on behalf of certain of its affiliates, including NRG, filed for bankruptcy, and concurrently sought authority to reject the power supply agreement.[494] In response to NRG's attempts to terminate the power supply agreement, the Connecticut attorney general and the Connecticut Public Utility Control (Connecticut Utility) petitioned FERC to stay the termination.[495] FERC then ordered NRG to continue to provide power to CLP pending further notice while it evaluated the proposed termination.[496]

After two days of hearings, the bankruptcy court authorized rejection of the power supply agreement but declined to enjoin FERC or to vacate the FERC order requiring NRG to continue supplying electricity.[497] NRG then petitioned the United States District Court for the Southern District of New York for declaratory and injunctive relief such that NRG be permitted to cease performance under the power supply agreement.[498] FERC also issued another order concluding, *inter alia*, that it had jurisdiction to review termination of the power supply agreement and affirmed its requirement that NRG continue to comply with the agreement pending resolution.[499] Ultimately, the bankruptcy

489. *Id.* (internal quotation marks omitted).
490. 28 U.S.C. §§ 1334(a), (e)(1) (2012).
491. NRG Power Mktg., Inc. v. Blumenthal (*In re* NRG Energy, Inc.), No. 03 Civ. 3754 RRC, 2003 WL 21507685, at *1 (S.D.N.Y. 2003).
492. *Id.*
493. *Id.*
494. *Id.*
495. *Id.*
496. *Id.*
497. *Id.* at *2.
498. *Id.*
499. *Id.*

court found that it did not have jurisdiction to grant NRG's requested relief, construing the Federal Power Act broadly, and, in particular, its edict that only federal courts of appeal may review FERC orders.[500]

In *In re Mirant*, the Fifth Circuit reached a different conclusion.[501] In 2000, prior to filing for bankruptcy, Mirant Corporation (Mirant) purchased all of the electric generation facilities of Potomac Electric Power Company (PEPCO) and took by assignment most of PEPCO's purchaser power agreements.[502] Because PEPCO could not receive consent to assign all of the purchase power agreements, PEPCO and Mirant agreed to an arrangement where Mirant would purchase from PEPCO an amount of electricity equal to PEPCO's obligation under the unassigned contracts, referred to as the "Back-to-Back Agreement" in the case.[503] The Back-to-Back Agreement provided for electricity rates that were higher than the market rate.[504]

After filing for bankruptcy, Mirant filed two motions in an adversary proceeding against FERC and PEPCO seeking rejection of the Back-to-Back Agreement (but not the Asset Purchase and Sale Agreement) and a temporary restraining order against FERC and PEPCO to prevent them from taking any actions to force Mirant to perform under the Back-to-Back Agreement.[505] Mirant also initiated another adversary proceeding against FERC and sought a temporary injunction to prevent FERC from taking any action to force Mirant to perform under any of Mirant's wholesale electric contracts.[506] The bankruptcy court held that it had authority to enjoin FERC and authorize rejection of the Back-to-Back Agreement and issued a preliminary injunction against FERC but withheld ruling on the merits of the rejection of the Back-to-Back Agreement.[507] After the reference to the bankruptcy court was withdrawn, the district court held its own hearings and reached a different conclusion.[508] The district court denied Mirant's request for injunctive relief and held that FERC had exclusive authority, such that Mirant had to seek relief from the filed rate in the Back-to-Back Agreement in a FERC proceeding.[509]

On appeal, the Fifth Circuit took a more literal approach to attempt to reconcile the apparent conflict between bankruptcy and FERC jurisdiction. As to rejection of the Back-to-Back Agreement, the Fifth Circuit relied on Bankruptcy Code § 365(g), which provides that rejection of a contract is a breach of such contract.[510] On the other hand, FERC does not have exclusive

500. *Id.* at *3–4.
501. Mirant Corp. v. Potomac Elec. Power Co. (*In re* Mirant Corp.), 378 F.3d 511, 518 (5th Cir. 2004).
502. *Id.* at 515.
503. *Id.*
504. *Id.* at 515–16.
505. *Id.* at 516.
506. *Id.*
507. *Id.*
508. *Id.*
509. *Id.*
510. *Id.* at 519.

jurisdiction over the breach of a FERC regulated contract where the breach is based upon something other than challenge to the filed rate.[511] Thus, the Fifth Circuit held that the district court did have jurisdiction to authorize rejection of the Back-to-Back Agreement so long as the rejection was not a challenge to the agreement's filed rate.[512]

Moreover, the Fifth Circuit noted that while there were multiple exceptions to the general authority under Bankruptcy Code § 365(a) for a debtor to reject executory contracts, Congress did not create an exception for FERC regulated contracts—even though Congress was keenly aware of such contracts as evidenced by Bankruptcy Code § 1129(a)(6), which generally requires government approval of any rate change for a Chapter 11 plan to be confirmed.[513] Thus, unlike the court in *NRG Power Marketing*, the Fifth Circuit reached a different conclusion in *Mirant* by narrowly construing rejection under Bankruptcy Code § 365(a) and, more importantly, what amounts to a challenge to the filed rate. However, while the Fifth Circuit would permit a district court to authorize the rejection of a FERC regulated contract, the standard for authorizing rejection is not the typical business judgment standard but a higher public interest standard.[514]

More recently, this issue was addressed in the Calpine Corporation (Calpine) bankruptcy.[515] Prior to its bankruptcy, Calpine entered into a number of long-term wholesale power agreements.[516] In bankruptcy, Calpine took an approach similar to Mirant and filed an adversary proceeding against FERC seeking a preliminary injunction to prevent FERC from requiring Calpine to continue to perform under the power agreements.[517] Calpine also sought to reject those power agreements.[518]

In the aftermath of *Mirant*, FERC issued an order adopting as its policy the Fifth Circuit's ruling in *Mirant*—specifically, that Bankruptcy Code § 365 is not preempted by the Federal Power Act, and that a district court could exercise jurisdiction over the rejection of FERC-regulated contracts.[519]

Notwithstanding this FERC order, the *Calpine* court framed the issue differently than *Mirant*, relying upon *N.L.R.B. v. Bildisco & Bildisco* to conclude that if bankruptcy court jurisdiction conflicts with a federal regulatory regime, the bankruptcy court must defer to the federal agency.[520] The *Calpine* court further found that provisions such as Bankruptcy Code § 362(b)(4), which

511. *Id.*
512. *Id.*
513. *Id.* at 521–22.
514. *Id.* at 525.
515. *See* Cal. Dep't of Water Res. v. Calpine Corp. (*In re* Calpine Corp.), 337 B.R. 27, 30 (S.D.N.Y. 2006).
516. *Id.* at 29.
517. *Id.* at 30.
518. *Id.*
519. *Id.* at 31.
520. *Id.* at 34 (citing N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)).

exempt governmental units from the automatic stay in certain situations, further support the notion that bankruptcy courts are to defer to federal agencies.[521] Accordingly, the district court held that it lacked jurisdiction to authorize rejection of the power agreements because it would "directly interfere with FERC's jurisdiction over the rates, terms, conditions, and duration of wholesale energy contracts."[522] More illuminating, the court further held that

> Calpine cannot achieve in Bankruptcy Court what neither it, nor any other party in this case, nor any other federally regulated energy company in the country could do without seeking FERC approval: cease performance under the rates, terms, and conditions of filed rate wholesale energy contracts in the hopes of getting a better deal.[523]

Seemingly at odds with *Mirant*, the court essentially held that the concept of "breach" creates a distinction without a difference. "Breach" in the context of a power agreement causes the "unilateral termination of a regulatory obligation," and is not a "run-of-the-mill contract dispute."[524] Because rejection of the power agreements would, in fact, cause their termination, rejection clearly interfered with FERC's jurisdiction over the power agreements.[525]

Unfortunately, these three decisions do not provide much clarity for how the conflict between FERC jurisdiction and bankruptcy jurisdiction should be resolved. On the one hand, *NRG Power Marketing* and *Calpine* essentially wipe rejection of FERC regulated contracts out of a power company's bankruptcy playbook, while *Mirant* offers a softer approach and may permit rejection in certain limited circumstances but subject to the heightened public interest standard.

C. Ring-Fencing

Another issue that arises when dealing with heavily regulated companies, such as power companies, is how to deal with any non-regulated industries in which those companies or their affiliates conduct business. The most obvious example of a company with both regulated and non-regulated businesses, and the solution to protect the regulated businesses, was Enron and its subsidiary Portland General Electric. While the bankruptcy of Enron is well documented, a measure enacted by an Oregon regulatory authority saved Portland General Electric from a similar fate.

The measure enacted by the Oregon Public Utility Commission is what is commonly called "ring-fencing."[526] While ring-fencing is a state-by-state

521. *Id.* at 35.
522. *Id.* at 36.
523. *Id.*
524. *Id.*
525. *Id.*
526. *See* Dr. Fred Grygiel & John Garvey, *Fencing in the Regulated Utilities*, 142 NO. 8 PUB. UTIL.

policy decision, the purpose behind ring-fencing is to insulate a subsidiary engaged in a regulated business from a parent company, and any other affiliates, engaged in non-regulated businesses. A ring-fenced entity should be functionally separate from its parent with its own accounting system, separate debt, separate preferred stock ratings, and independent financing.[527] By ring-fencing the regulated company from other activities, customers of utilities are prevented from having to bear the cost and risk of the unregulated businesses of affiliated entities.[528]

Thus, with these goals in mind, when Enron acquired Portland General Electric in 1997, the Oregon Public Utility Commission required, *inter alia*, that Portland General Electric maintain a minimum 48% common equity ratio in its capital structure to ensure separateness of Portland General Electric from its parent, Enron.[529] When Enron filed for bankruptcy, Portland General Electric was able to distance itself, at least in some measure, from the effects of Enron's bankruptcy. For example, while Enron's credit rating tanked, Portland General Electric managed to maintain a credit rating eight levels higher than that of Enron.[530]

Ring-fencing is a regulatory tool that is derived either from statutory powers granted to regulatory authorities or imposed as conditions to settlements in rate cases and mergers and acquisitions involving public utilities.[531] Thus, while a utility may already be ring-fenced prior to the bankruptcy of its parent, ring-fencing is relevant because of the bankruptcy insulation it provides to regulated companies based upon the structural mechanisms required by regulators.

VIII. RENEWABLE ENERGY

The term "renewable energy" encompasses a wide variety of alternative energy sources such as solar, wind, hydro, geothermal, and biomass.[532] Like energy companies dealing with traditional fossil fuels, there are broad and diverse renewable energy companies fulfilling various roles within the energy industry.

Of particular importance from a bankruptcy standpoint are companies that own and develop technologies used in renewable energy projects. For example, in the solar industry, companies producing PV solar cells rely upon their patents and intellectual property to separate themselves from other PV solar cell producers.[533] These types of companies have been subject to

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FORT. 32, 32 (2004).

527. *Id.*

528. *Id.*

529. *See* CHARLES E. PETERSON & ELIZABETH M. BRERETON, REPORT ON RING-FENCING, (Utah State Department of Commerce, 2005).

530. *Id.*

531. *See* Grygiel & Garvey, *supra* note 526, at 32.

532. *See Our Energy Choices: Renewable Energy*, UNION OF CONCERNED SCIENTISTS, http://www.ucsusa.org/clean_energy/our-energy-choices/renewable-energy/ (last visited Oct. 30, 2014).

533. *See* Yu-Shan Su, *Competing in the Global Solar Photovoltaic Industry: The Case of Taiwan*,

significant competition and cost pressures leading to many filing for bankruptcy over the last handful of years, including, among others, Evergreen Solar, Inc., Solar Trust of America, LLC, Energy Conversion Devices, Inc., Suntech Power Holdings Co., Ltd., and most notoriously, Solyndra LLC.[534]

Relatedly, most renewable energy sources cannot produce a constant stream of power, requiring the use of energy storage systems.[535] These energy storage systems rely upon intellectual property owned or licensed by a company that specializes in the development of systems that store excess electricity or distribute stored electricity to meet demand.[536] In the last few years, at least two of these companies, Beacon Power, LLC[537] and Xtreme Power, Inc., have filed for bankruptcy.[538]

Thus, when a renewable energy technology company files for bankruptcy, a key (and potentially primary) asset is the intellectual property owned or licensed by the company. The Intellectual Property Bankruptcy Act enacted in 1998 amended the Bankruptcy Code by, *inter alia*, adding new Bankruptcy Code § 365(n) to provide protections for licensees of intellectual property.[539] The ultimate purpose of Bankruptcy Code § 365(n) is to "make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to [Bankruptcy Code §] 365."[540] To accomplish this purpose, Bankruptcy Code § 365(n) preserves the rights of a licensee pending rejection by requiring the licensor to (a) perform or provide the intellectual property (and any embodiments) to the extent provided in the license and (b) not interfere with a licensee's rights.[541] These protections can be critical to the licensee for maintenance and ongoing operations of its business that may be dependent on use of software and other intellectual property.

Upon rejection of an intellectual property license, Bankruptcy Code § 365(n) gives licensees the right to elect one of two options: (a) treat the license as terminated by rejection (if rejection amounts to a breach that would entitle the licensee to treat the license as rejected based upon the agreement, applicable nonbankruptcy law, or an agreement made by the licensee with another entity), or (b) retain its rights (including the right to enforce any exclusivity provision)

INT'L. J. PHOTOENERGY, vol. 2013, article ID 794367, Feb. 4, 2013, at 3.

534. Nos. 11-12590 (Bankr. D. Del.); 12-11136 (Bankr. D. Del.); 12-43166 (Bankr. E.D. Mich.); 14-10383 (Bankr. S.D.N.Y.); and 11-12799 (Bankr. D. Del.), respectively.

535. *See* H. Ibrahim et al., *Energy Storage Systems—Characteristics and Comparisons*, 12 RENEWABLE AND SUSTAINABLE ENERGY REVIEWS 1221, 1223 (2008).

536. *Id.*

537. No. 11-13450 (Bankr. D. Del.).

538. No. 14-10096 (Bankr. W.D. Tex.).

539. Intellectual property under Bankruptcy Code § 101(35A) means: (A) trade secret; (B) invention, process, design, or plant protected under title 35; (C) patent application; (D) plant variety; (E) work of authorship protected under title 17; or (F) mask work protected under chapter 9 of title 17; to the extent protected by applicable nonbankruptcy law. 11 U.S.C. § 101(35A) (2012).

540. S. REP. NO. 100-505 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200.

541. 11 U.S.C. § 365(n)(4).

under the license and any supplementary agreements as such rights existed immediately before the bankruptcy case commenced.[542] If a licensee elects to retain its rights, its rights will continue for the duration of the license and for any period for which the license may be extended by the licensee as of right under applicable nonbankruptcy law.[543] Additionally, the licensee must continue to make all "royalty payments" due under the license for the period in which it retains such intellectual property rights.[544] Any right of setoff under the license and any claim allowable under Bankruptcy Code § 503(b) are also waived.[545]

However, if the underlying intellectual property is sold, Bankruptcy Code § 365(n)'s relevance is unclear. Generally, sales of a debtor's assets are governed by Bankruptcy Code § 363. Bankruptcy Code § 363 does not reference Bankruptcy Code § 365(n), and by its terms, Bankruptcy Code § 365(n) deals only with rejection of an intellectual property license (or the treatment of such license pending rejection). Pursuant to Bankruptcy Code § 363(f), assets of the Debtor may be sold free and clear of any interest in such property.[546] This leads to a potential conflict between Bankruptcy Code § 365(n), which gives intellectual property licensees the option to retain their rights, and Bankruptcy Code § 363(f), which would otherwise permit the Debtor to sell its intellectual property free and clear of those rights.

This is precisely the concern expressed by a prospective licensee in the case of *In re Dynamic Tooling Systems, Inc.*[547] In *Dynamic Tooling*, the prospective licensee sought to prevent the sale of the underlying intellectual property free and clear of its claimed licensee interest.[548] Notwithstanding that the license at issue had yet to become effective, the bankruptcy court analyzed whether Bankruptcy Code § 363(f) could terminate a licensee's rights under § 365(n).[549] Examining cases involving Bankruptcy Code § 365(h), which provides similar protections to lessees, the bankruptcy court ultimately held that it could utilize the adequate protection requirement of Bankruptcy Code § 363(e) to protect the licensee's rights and make the sale subject to the licensee's rights.[550] Case law regarding Bankruptcy Code § 365(n) is limited, and there is virtually no additional analysis of the interplay of Bankruptcy Code § 365(n) and § 363(f) outside of *Dynamic Tooling*.[551]

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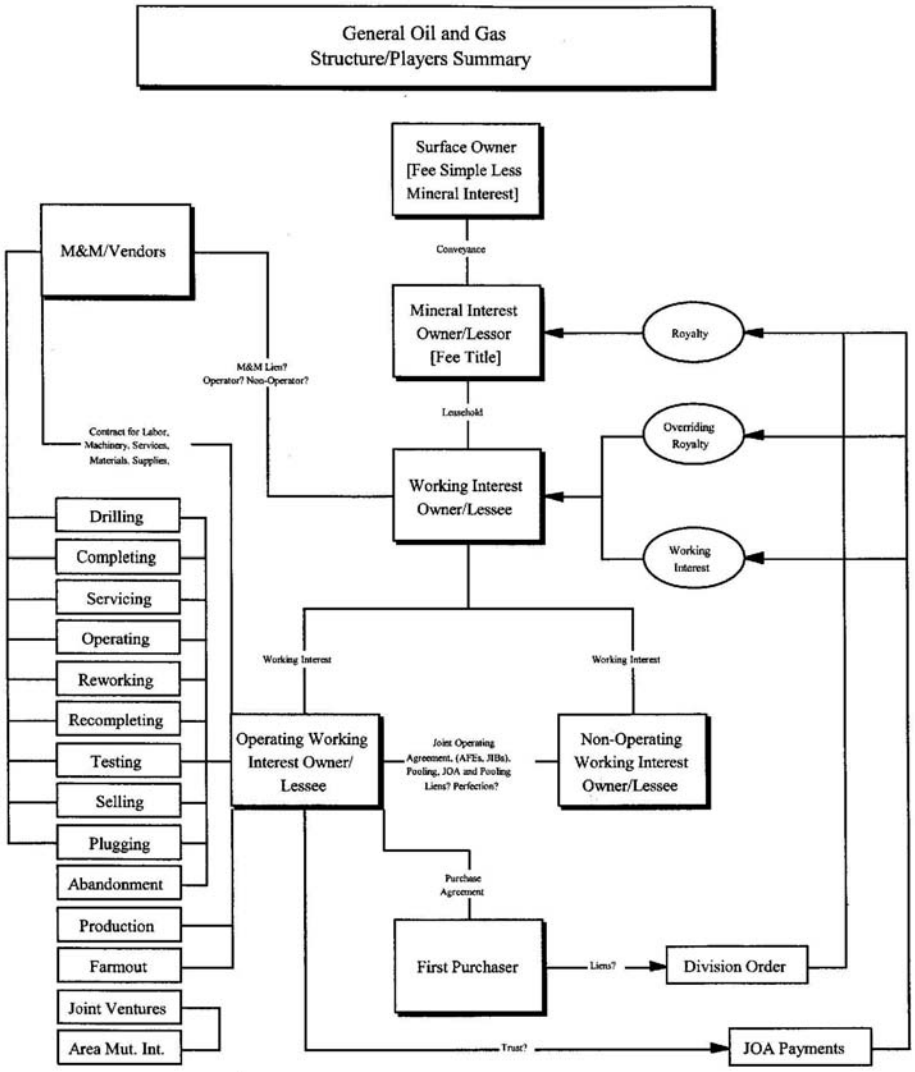
542. *Id.* § 365(n)(1).
543. *Id.*
544. *Id.* § 365(n)(2).
545. *Id.*
546. *Id.* § 363(f).
547. *In re* Dynamic Tooling Sys., Inc., 349 B.R. 847, 854 (Bankr. D. Kan. 2006).
548. *Id.* at 854–55. *Cf* Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537, 548 (7th Cir. 2003) (holding that Bankruptcy Code § 363(f) permits the sale of property free and clear of the possessory interest available to lessees under Bankruptcy Code § 365(h)).
549. *In re Dynamic Tooling*, 349 B.R. at 855–56.
550. *Id.*
551. It should be noted, however, that a debtor seeking to sell property free and clear of interests pursuant to Bankruptcy Code § 363(f) must still meet all of the requirements set forth therein. 11 U.S.C.

IX. CONCLUSION

Financially distressed firms in the energy industry present complex factual and legal issues in the restructuring and reorganization process. The combination of the Bankruptcy Code, state property law, and state and federal regulatory law comes into play in the energy restructuring and reorganization arena. While there may be general similarities in the energy restructuring and reorganization process as compared to other industries, effective resolution of a complex energy restructuring and reorganization requires an understanding of the unique aspects of the energy industry sector involved, as well as the nuances of bankruptcy and other applicable law. The stakes can be high given the capital investment and debt required to start and operate in the energy industry. When coupled with cyclical price volatility and inherent risks of finding, producing, processing, and delivering energy, resolution of problems and issues via restructuring and reorganization is, from time to time, the most appropriate tool to maximize recoveries for stakeholders.

§ 365(f). The relevance of the interplay of Bankruptcy Code § 365(n) and § 363(f) is whether a licensee's rights under Bankruptcy Code § 365(n) would be preserved in a sale as a matter of right under the Bankruptcy Code.

APPENDIX A. SCHEMATIC OF UPSTREAM OIL AND GAS



APPENDIX B. FIFTY-STATE SURVEY: OIL AND GAS LEASES AS EXECUTORY CONTRACTS OR UNEXPIRED LEASES

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Ala.	N/A	N/A	Corporeal hereditament	Willcutt v. Union Oil Co., 432 So.2d 1217, 1221 (Alaska 1983).
Alaska	N/A	N/A	Unclear	
Ariz.	N/A	N/A	Depends on documents	Phoenix v. S. Bank Corp., 649 P.2d 293, 297–98 (Ariz. Ct. App. 1982).
Ark.	Probably	Hill v. Larcon Co., 131 F. Supp. 469 (W.D. Ark. 1955) (decided under § 110(b) of the Bankruptcy Act of 1898, predecessor to § 365 of the Code).	"Easement and interest in land itself"	Pasteur v. Niswanger, 290 S.W.2d 852, 854 (Ark. 1956).
Cal.	Not as an executory contract	Laugharn v. Bank of Am. Nat. Trust & Sav. Ass'n, 88 F.2d 551, 553 (9th Cir. 1937).	"Incorporeal hereditament"	Gerhard v. Stephens, 442 P.2d 692, 705–705 (Cal. 1968).
Colo.	N/A	N/A	Interest in "realty"	Simson v. Langholf, 293 P.2d 302, 307 (Colo. 1956).
Conn.	N/A	N/A	Unclear	
Del.	N/A	N/A	Unclear	
Fla.	N/A	N/A	"Real property"	Straughn v. Sun Oil Co., 345 So.2d 1062, 1062–1065 (Fla. 1977).

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Ga.	N/A	N/A	Fee type interest	Rockefeller v. First Nat'l Bank of Brunswick, 100 S.E.2d 279 (Ga. 1957).
Haw.	N/A	N/A	Unclear	
Idaho	N/A	N/A	"Real property"	Kirk Family Trust v. Seideman (*In re* Estate of Kirk), 907 P.2d 794, 801 (Idaho 1995).
Ill.	No	*In re* Hanson Oil Co., Inc., 97 Bankr. 468, (Bankr. S.D. Ill. 1989).	Fee type interest, "freehold interest in the real estate"	Transcon. Oil Co. v. Emmerson, 131 N.E. 645, 649 (Ill. 1921).
Ind.	N/A	N/A	"Exclusive right to drill" and "incorporeal hereditament"	Halbert v. Hendrix, 95 N.E.2d 221, 223 (Ind. Ct. App. 1950).
Iowa	N/A	N/A	Probably real property	Smith v. Smith, 2009 Iowa App. LEXIS 1360, *13–14 (Iowa Ct. App. Nov. 12, 2009).
Kan.	Yes	*In re* J.H. Land & Cattle Co. Inc., 8 B.R. 237 (Bankr. W.D. Okla. 1981) (applying Kansas law).	"[P]ersonal property, an incorporeal hereditament, a profit a prendre" and for some purposes real estate	Caney Valley Nat'l Bank v. Alexander (*In re* Wolfe), 181 B.R. 90, 91 (Bankr. D. Kan. 1995). However, a royalty interest is personal property. *Id.*

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Ky.	No	K & D Energy v. KY USA Energy, Inc. (*In re* KY USA Energy, Inc.), 444 B.R. 734, 737 (Bankr. W.D. Ky. 2011).	Fee type, "separate estate" of minerals.	Bigge v. Tallent, 539 S.W.2d 288, 289 (Ky. 1976).
La.	Split	*Compare In re* WRT Energy Corp., 202 B.R. 579, 583–84 (W.D. La. 1996) (holding that a mineral lease in Louisiana is not an executory contract), *with* Texaco, Inc. v. La. Land & Exploration Co., 136 B.R. 658, 668 (M.D. La. 1992) (holding that a mineral lease in Louisiana is an executory contract), *and* Texaco Inc. v. Bd. of Comm'r for the LaFourche Basin Levee Dist. (*In re* Texaco Inc.), 254 B.R. 536, 565 (Bankr. S.D.N.Y. 2000) (same).	Fee type, "incorporeal immovable"	Succession of Simms, 195 So.2d 114, 127–28 (La. 1965).
Me.	N/A	N/A	Unclear	
Md.	N/A	N/A	Possibly fee interest	Kiser v. Eberly, 88 A.2d 570, 571–72 (Md. 1952) (looking with favor at jurisdictions that hold that oil and gas leases are fee interests, but not deciding the issue).

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Mass.	N/A	N/A	Profits a prendre	Davisson v. Comm'r of Revenue, 470 N.E.2d 413, 417 (Mass. App. Ct. 1984).
Mich.	Yes	Frontier Energy, LLC v. Aurora Energy, Ltd. (*In re* Aurora Oil & Gas Corp.) 439 B.R. 674 (Bankr. W.D. Mich. 2010); *In re* P.I.N.E., Inc., 52 B.R. 463, 465–68 (Bankr. W.D. Mich. 1985).	Profits a prendre	Stevens Mineral Co. v. State, 418 N.W.2d 130, 134 (Mich. Ct. App. 1987).
Minn.	Yes	*In re* Huff, 81 B.R. 531 (Bankr. D. Minn. 1988).	Probably profits a prendre	Hanson v. Fergus Falls Nat'l Bank, 65 N.W.2d 857, 863–64, (Minn. 1954) (dicta).
Miss.	N/A	N/A	Part of "land"	Stern v. Great S. Land Co., 114 So. 739 (Miss. 1927).
Mo.	N/A	N/A	Probably real	Gen. Refractories Co. v. Raack, 674 S.W.2d 97, 99–100 (Mo. Ct. App. 1984) (finding possessors of surface estate had acquired title to mineral estate by adverse possession).
Mont.	N/A	N/A	Fee type interest	Stokes v. Tutvet, 328 P.2d 1096 (Mont. 1958).

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Neb.	N/A	N/A	Fee interest, "vested property rights"	Wheelock v. Heath, 272 N.W.2d 768, 771 (Neb. 1978).
Nev.	N/A	N/A	Unclear, dependent on documents	Paul v. Cragnaz, 60 P. 983, 984 (Nev. 1900).
N.H.	N/A	N/A	Unclear	
N.J.	N/A	N/A	Profits a prendre	Hopper v. Herring, 67 A. 714, 717 (N.J. Sup. Ct. 1907).
N.M.	No	*In re* Antweil, 97 B.R. 65, 66–67 (Bankr. D.N.M. 1989).	Probably fee type interest	Terry v. Humphreys, 203 P. 539, 543 (N.M. 1922) (Oil and gas lease "[is] more than a chattel interest or a mere license or incorporeal hereditament.").
N.Y.	N/A	N/A	Easement and incorporeal hereditament	Banach v. Home Gas Co., 199 N.Y.S.2d 858, 859 (N.Y. Sup. Ct. 1960).
N.C.	N/A	N/A	"Profit a prendre" and "estate in the land"	*In re* Lee, 354 S.E.2d 759, 761 (N.C. Ct. App. 1987) (citing Council v. Sanderlin, 111 S.E. 365 (N.C. 1922)).
N.D.	N/A	N/A	"Interest in real property"	Nantt v. Puckett Energy Co., 382 N.W.2d 655 (N.D. 1986).

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Ohio	Split	*In re* Frederick Petroleum Corp., 98 B.R. 762, 766 (S.D. Ohio 1989) (not eligible); *In re* Gasoil, Inc., 59 Bankr. 804 (Bankr. N.D. Ohio 1986) (eligible under Bankruptcy Code section 365).	Unclear	*Compare* Back v. Ohio Fuel Gas Co., 113 N.E.2d 865 (Ohio 1953) (license), *with* Bath Twp. v. Raymond C. Firestone, Co., 747 N.E.2d 262, 264–65 (Ohio Ct. App., Summit County 2000) (questioning the holding in *Back* as dicta and finding rights may be appurtenant to land).
Okla.	No	*In re* Clark Res., 68 B.R. 358 (Bankr. N.D. Okla. 1986).	Incorporeal hereditament	Rich v. Doneghey, 177 P. 86 (Okla. 1918).
Or.	N/A	N/A	"Real Property"	Fremont Lumber Co. v. Starrell Petroleum Co., 364 P.2d 773 (Or. 1961).
Pa.	Yes	Powell v. Anadarko E&P Co. LP (*In re* Powell), 482 B.R. 873, 875 (Bankr. M.D. Pa. 2012).	Lease is license; once minerals found it is a fee interest	Powell v. Anadarko E&P Co. LP (*In re* Powell), 482 B.R. 873, 875 (Bankr. M.D. Pa. 2012).
R.I.	N/A	N/A	Unclear	
S.C.	N/A	N/A	Unclear	Massot v. Moses, 3 S.C. 168 (S.C. 1871) (discussing mining for phosphates suggests right is real).
S.D.	N/A	N/A	Unclear	

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Tenn.	N/A	N/A	"Realty"	Murray v. Allred, 43 S.W. 355, 356 (Tenn. 1897).
Tex.	No	*See* River Prod. Co. v. Webb (*In re* Topco, Inc.), 894 F.2d 727, 739 n.17 (5th Cir. 1990); *see also* Terry Oilfield Supply Co., v. Am. Sec. Bank, N.A., 195 B.R. 66, 70 (S.D. Tex. 1996) ("A mineral lease . . . is a determinable fee. It is not a lease or other form of executory contract that a debtor may accept or reject.").	Fee interest	Stephens Cnty. v. Mid-Kansas Oil & Gas Co., 254 S.W. 290, 291 (Tex. 1923).
Utah	No	Emery Res. Holdings, LLC v. Coastal Plains Energy, Inc., 2010 WL 1257761 (D. Utah Mar. 26, 2010).	Real estate	Andalex Res. v. Myers, 871 P.2d 1041, 1045 (Utah Ct. App. 1994) (citing Chase v. Morgan, 339 P.2d 1019, 1021 (1959)).
Vt.	N/A	N/A	Unclear	
Va.	N/A	N/A	Unclear, depends on documents	Bistic v. Bostic, 99 S.E.2d 591, 594 (Va. 1957).
Wash.	N/A	N/A	Unclear	
W. Va.	N/A	N/A	Fee interest	Powers v. Union Drilling Inc., 461 S.E.2d 844, 849 (W. Va. 1995).

State	Oil or Gas Lease Eligible Under 365?	Supporting Citation for 365 Issue	Classification of Lease Property Interest	Citation for Property Interest
Wis.	Yes	*In re* Myklebust, 26 B.R. 582 (Bankr. W.D. Wis. 1983).	"Interest in the land"	Chi. & N.W. Transp. v. Pedersen, 259 N.W.2d 316 (Wis. 1977).
Wyo.	N/A	N/A	Real Property	Kennedy Oil v. Lance Oil & Gas Co., 126 P.3d 875, 878–89 (Wyo. 2006).

APPENDIX C. FIFTY-STATE SURVEY: ROYALTY/FIRST PURCHASER LIENS

State	Statute	When to Perfect	Duration of Lien	Notes
Kan.	KAN. STAT. ANN. § 84-9-339a (2005).	Depends on jurisdiction	Indefinitely for production, accounts, chattel paper, instruments, documents, or cash	Lien attaches to proceeds, chattel paper, etc., from production.
Miss.	MISS. CODE ANN. § 53-3-41 (2011).	Indefinite	One year after effectiveness of lien, tolled by insolvency proceeding or judicial action	Lien attaches to proceeds from production attributable to royalty owner's interest.
N.M.	N.M. STAT. ANN. §§ 48-9-1 to -8 (2014).	15–45 days after indebtedness	One year after filing	Lien attaches to proceeds from production attributable to royalty owner's interest.
N.D.	N.D. CENT. CODE §§ 35-37-01 to -06 (2014).	Ninety days after production	One year after filing	Lien applies to oil and gas proceeds.
Okla.	OKL. STAT. tit. 52, §§ 549.1–12 (2011).	Automatically perfected	Attaches until last day of calendar month one year after indebtedness	Lien applies to oil and gas proceeds.
Tex.	TEX. BUS. & COM. CODE § 9.343 (West 2011).	Automatically perfected	Indefinitely in production, accounts, chattel paper, instruments, documents, or cash (but sale to first purchaser in ordinary course cuts off interest in production itself)	Lien applies to accounts, chattel paper, instruments, documents, payment intangibles, inventory, production, or cash.

APPENDIX D. FIFTY-STATE SURVEY: SCOPE OF M&M LIENS

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Ala.	ALA. CODE §§ 35-11-210 to -234 (1991).	Six months after completion for contractor, 30 days after completion for journeyman, four months after completion for all other persons	Six months after indebtedness	Lien is for work on "improvements." Lien extends to all right and title of owner of property.
Alaska	ALASKA STAT. §§ 34.35.050–.170 (2012).	120 days after completion	Six months after filing	Lien attaches to whole of oil, gas or mineral well, so long as the property is in one mass and can be identified as being produced by the labor of the lienor.
Ariz.	ARIZ. REV. STAT. ANN. §§ 33-981 to -1008 (2014).	120 days after completion	Six months after filing	When separately owned property is embraced within one established drilling unit, and a pooling of interests is established, the owner drilling and operating for the benefit of others has a lien on the share of production from the unit accruing to the interest of each of the owners for the payment of his share of the expenses.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Ark.	ARK. CODE ANN. §§ 18-44-101 to -206 (2003).	120 days after completion	Fifteen months after filing	Lien attaches to the land, building, and any appurtenances on property for any mechanics work or materials supplied for oil and gas well. However, for labor or material that is supplied to a leaseholder, this lien will not attach to the underlying land, only to the lease.
Cal.	CAL. CIV. CODE §§ 8000–8848, 9000–9566 (West 2012).	Six months after completion	Ninety days after recordation	Lien for work and materials provided to an oil and gas well attaches to the land and improvements as well as proceeds.
Colo.	COLO. REV. STAT. ANN. §§ 38-22-101 to -133 (West 2007).	Two months after completion for laborers, and four months after completion for all other persons	Six months after filing	A party who performs labor upon or furnishes machinery, material, fuel, explosives, power, or supplies for sinking, repairing, altering, or operating any oil or gas well by virtue of a contract is entitled to an M&M lien. Severed oil and gas is not eligible under a mechanic's lien. An overriding royalty interest is immune from mechanic's liens, but a carried working interest is susceptible to them. AEC Indus., LLC v. Survivor Oil, Inc., 7 P.3d 1052, 1056 (Colo. App. 1999).
Conn.	CONN. GEN. STAT. ANN. §§ 49-33 to -92f (West 2006).	Ninety days after completion	One year after filing	Unclear if oil and gas work is considered an eligible "improvement" under state law.
Del.	N/A	N/A	N/A	Lien does not extend to oil or gas facilities.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Fla.	FLA. STAT. ANN. §§ 713.001–.37 (West 2013).	Ninety days after completion	One year after perfection	Lien may exist for improvements to leasehold interest in oil and gas property or for any oil and gas pipeline, except lien will not attach to the land itself or any royalty interest.
Ga.	GA. CODE ANN. §§ 44-14-360 to -366 (2002).	Ninety days after completion	One year after perfection	Lien is for improvements to real property and extends to "other property." The application to oil and gas facilities is unclear.
Haw.	HAW. REV. STAT. ANN. §§ 507-41 to -49 (Lexis 2006).	Ninety days after completion	Six months after filing of claim	Lien is for improvements to real property. The application to oil and gas properties is unclear.
Idaho	IDAHO CODE ANN. §§ 45-501 to -525 (2014).	Ninety days after completion	Six months after filing of claim	Lien applies to any person furnishing work or materials in a mining enterprise. Lien attaches to land (to the extent of the interest of the hiring party), buildings and improvements.
Ill.	770 ILL. COMP. STAT. ANN. 60/0.01 to 60/39 (West 2011).	Two years after completion	Two years after completion of work	Lien applies to any person furnishing work or materials for an oil and gas well under contract (or subcontract) with land owner. Lien extends to all real property under the land or lease (except for underlying fee) and also to oil and gas produced from the property, but does not extend to royalty interests.
Ind.	IND. CODE ANN. §§ 32-28-3-1 to -18 (West 2013).	Ninety days after completion	One year after recordation	Lien applies for work on oil and gas properties. Lien extends to all improvements and the land itself. *See* McCartin McAuliffe Mech. Contractor, Inc. v. Midwest Gas Storage, Inc., 685 N.E.2d 165 (Ind. Ct. App. 1997).

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Iowa	IOWA CODE ANN. §§ 572.1–.34 (West 1992).	Notice must be sent thirty days after completion	Two years and ninety days after completion	Lien applicable for labor relating to oil and gas wells. Lien attaches to lease, wells, minerals, pipelines, structures, etc.
Kan.	KAN. STAT. ANN. §§ 60-1101 to -1110 (2005).	Six months after completion	Six months after filing	Lien applies for improvements made to oil and gas wells. Lien attaches to all property improved through work.
Ky.	KY. REV. STAT. ANN. §§ 376.010–.260 (Lexis 2002).	Six months after completion	One year after filing	Lien extends to persons improving/furnishing labor or materials to a lessee and extends to the entire lease interest.
La.	LA. REV. STAT. ANN. §§ 9:4801–9:4861, 38:2242, 38:2247 (2007).	180 days after completion	One year after last day of possible filing	Lien applies for work done for oil and gas properties and extends to proceeds, the lease, all the equipment used, etc.
Maine	N/A	N/A	N/A	Lien does not extend to work done on oil and gas properties.
Md.	MD. CODE ANN., REAL PROP. §§ 9-101 to -304 (Lexis 2007).	180 days after completion	One year after filing	The application to oil and gas interests is unclear.
Mass.	MASS. GEN. LAWS ANN. ch. 254, §§ 1–33 (West 2004).	Varies depending on circumstances	Varies depending on circumstances	Lien only extends for work done on buildings or structures.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Mich.	MICH. COMP. LAWS ANN. §§ 570.1101–.1305 (West 2007).	Six months after completion	One year after completion	Lien applies for work done to improvements of real property and extends to entire interest in real property of contracting owner or lessee. This includes any oil and gas leasehold, pipelines, structure, building, or any other value furnished.
Minn.	MINN. STAT. ANN. §§ 514.01–.18 (West 2014).	120 days after completion	One year after completion	Lien applies for any work done on any mine. Lien applies to the interest and title of owner in land up to 80 acres, and in case of a homestead, 40 acres.
Miss.	MISS. CODE ANN. §§ 85-7-131 to -265 (2011).	One year from when debt is due	One year from when debt is due	Lien applies for work done on fixed machinery, structures, or buildings. This lien extends for work done on drilling rigs and for the value of the rigs and equipment (but not the underlying land or other buildings and fixtures). White v. Cabot Corp., 194 So.2d 499 (Miss. 1967). However, lien probably does not extend to actual oil and gas proceeds.
Mo.	MO. ANN. STAT. §§ 429.005–.360 (West 2010).	Six months after debt is due	Six months after filing	Operator has lien on proceeds against co-poolees for M&M work done on wells.
Mont.	MONT. CODE ANN., §§ 71-3-521 to -563 (2014).	Ninety days after completion	Two years after filing	Lien applies for improvements made to oil and gas wells. Lien attaches to owned interest of contracting party with certain caveats.
Neb.	NEB. REV. STAT. §§ 52-110 to -159 (2010).	Four months after completion	Two years after filing	Lien extends for improvements to wells or pipelines and applies to the leasehold's interest in the well including the oil and gas produced.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Nev.	NEV. REV. STAT. §§ 108.221–.246 (2013).	Ninety days after completion	Six months after filing	Lien applies to work done in excess of $500 on mines or other excavations. Lien attaches to the "mine."
N.H.	N.H. REV. STAT. ANN. §§ 447:1 to 447:14 (2013).	Statement of work required every thirty days	120 days after completion	Lien applies to "wells" and extends to interest of owner in buildings and lands.
N.J.	N.J. STAT. ANN. §§ 44A-1 to 45-5 (1993).	Ninety days after completion	One year after completion	Lien applies to any contractor (no statutory definition) or supplier who works pursuant to a written contract.
N.M.	N.M. STAT. ANN. §§ 48-2-1 to -17, 48-2A-1 to -12 (2014).	120 days after completion for original contractor, 90 days for all others	Two years after filing	Lien for work on oil and gas wells has lien on leasehold, equipment, etc., but not to underlying fee or royalty interest.
N.Y.	N.Y. LIEN LAW §§ 3 to 39-C (West McKinney 2007).	Eight months after completion	One year after filing	Lien applies for all work done to construct or improve oil and gas wells and extends owner's right and title including the lease itself and right to produce oil and gas.
N.C.	N.C. GEN. STAT. ANN. §§ 44A-7 to -23 (West 2013).	120 days after completion	180 days after completion	Lien applies to improvements made to real property. Unclear whether lien applies to oil and gas interests.
N.D.	N.D. CENT. CODE §§ 35-27-01 to -28 (2014).	Ninety days after contribution	Three years after recordation	Lien applies to improvements made regarding oil and gas wells. Lien extends to landowner's interest in real property.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Ohio	OHIO REV. CODE ANN. §§ 1311.01–.38 (West 2004).	120 days after completion	Six years after filing	Applies to work or materials furnished pursuant to an oil or gas lease. Lien extends to interest of owner or leaseholder of the mineral estate including the oil and gas of the mineral estate and proceeds.
Okla.	OKLA. STAT. tit. 42, §§ 141–180 (2011).	180 days after completion or delivery	One year after filing	Applies to work or materials furnished pursuant to an oil or gas lease. Lien extends to interest of the oil and gas lease including the oil and gas of the mineral estate and proceeds.
Or.	OR. REV. STAT. §§ 87.001–88.093 (2013).	Seventy-five days after completion	Two years after filing	Unclear if M&M liens apply to oil and gas properties. Oil and gas properties not listed in expansive, but not complete list of examples of eligible improvements.
Pa.	49 PA. STAT. ANN. §§ 1101–1902 (West 2001).	Four months after completion	Two years after filing	Unclear if "improvement," which applies for M&M liens, includes oil and gas properties.
R.I.	R.I. GEN. LAWS §§ 34-28-1 to -37 (2011).	200 days after completion	Forty days after recordation	Unclear if "improvement," which applies for M&M liens, includes oil and gas properties.
S.C.	S.C. CODE ANN. §§ 29-5-10 to -430, 29-6-10 to -60, 29-7-10 to -30 (1991).	Ninety days after completion	Six months after completion	Lien applies to buildings and structures, unclear application to oil and gas properties.
S.D.	S. D. CODIFIED LAWS §§ 44-9-1 to -53, 44-9A-1 to -5 (2004).	120 days after completion	Six years after completion	Lien may be filed for work in constructing or improving oil and gas wells. Lien extends to the entire fee simple of the property and equipment, etc., located on the property.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Tenn.	TENN. CODE ANN. § 147 (2007).	Ninety days after completion	Ninety days or one year after completion depending on type of contractor	Lien for oil and gas work extends to entire leasehold, including minerals and equipment.
Tex.	TEX. PROP. CODE ANN. §§ 53.001 to .260, 56.001 to .045 (West 2014); TEX. CIV. PRAC. & REM. CODE § 12.002 (West 2002).	Six months after debt is due	Two years after last day claimant could file	Lien for work on oil and gas wells extends to land, lease, equipment, minerals, etc., but not to fee title of property.
Utah	UTAH CODE ANN. §§ 38-1a-1 to 38-1-29, 38-10-101 to -115, 38-11-101 to -302 (LexisNexis 2011).	Ninety days after notice of completion; 180 days after completion if no notice is filed	180 days after filing	M&M lien applies for work done on oil and gas wells and extends to mineral interest in the estate, including access, equipment, and production.
Vt.	VT. STAT. ANN. tit. 9, §§ 1921–1928 (2011).	180 days after payment is due	180 days after filing	Lien extends for work done to improve real property. Unclear whether lien applies to oil and gas interests.
Va.	VA. CODE ANN. §§ 43-1 to -71 (2013).	Ninety days after last day of month of completion	Later of six months from recordation or sixty days of completion	Applies to all persons furnishing labor or materials, including wells or excavations. Extends to the interest in the land or buildings or structures of the contracting party.

State	Statutes	Perfection Deadline*	Duration	Relation to Oil and Gas Interests
Wash.	WASH. REV. CODE ANN. §§ 60.04.011–.904 (West 2004).	Ninety days after completion	Eight months after recordation	Lien applies to improvements of real property.
W. Va.	W. VA. CODE ANN. §§ 38-2-1 to -39, 38-12-1 to -13 (Lexis 2011).	100 days after completion	Six months after filing	Lien probably applies to work done on oil and gas wells, lien extends to interest in owner of land and improvement. Knawha Oil & Gas Co. v. Wenner, 76 S.E. 893 (W. Va. 1912).
Wis.	WIS. STAT. ANN. §§ 779.01–.17 (West 2001).	Six months after completion	Two years after filing	Lien applies to improvements, including excavations. Lien extends to interest of owner.
Wyo.	WYO. STAT. ANN. §§ 29-3-103 to -105 (2013).	180 days after completion	180 days after filing	Lien applies to work constructing or improving oil and gas properties. Lien extends to interest of contracting party, including oil and gas proceeds, but does not apply to a separately owned fee or royalty interest.