

# **What Do ERR, DRB, PDR and PUD Have to Do with It? Unscrambling the Alphabet Soup of Energy Cases**

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## Oil and Gas Primer

### 21<sup>st</sup> Annual Southeast Bankruptcy Workshop

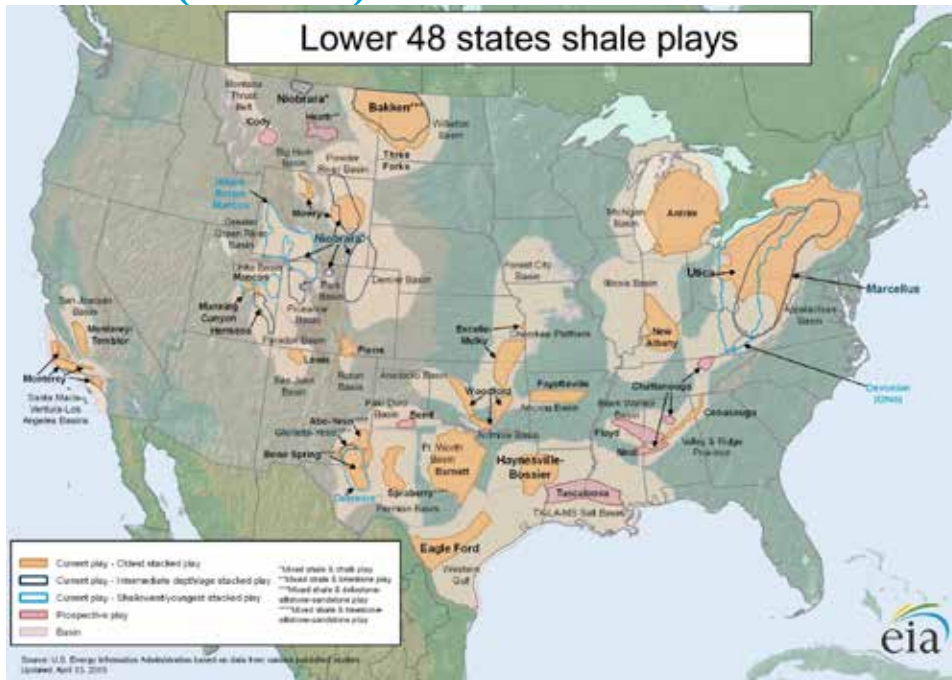
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## Basics of the Exploration and Production Business

### EXPLORATION BASICS

— “Basins” and “Fields” in the United States

## Basics of the Exploration and Production Business (cont'd)



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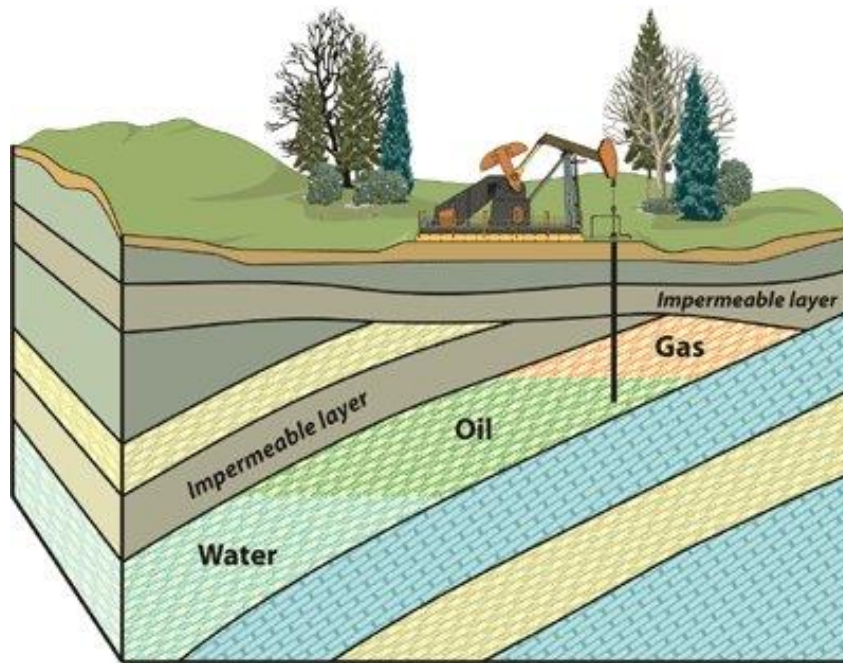
## Basics of the Exploration and Production Business (cont'd)

- Geologic Conditions for Exploration
  - Permeable and Impermeable Rock Formations
  - Sedimentary Rock
  - Igneous Rock

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## Basics of the Exploration and Production Business (cont'd)



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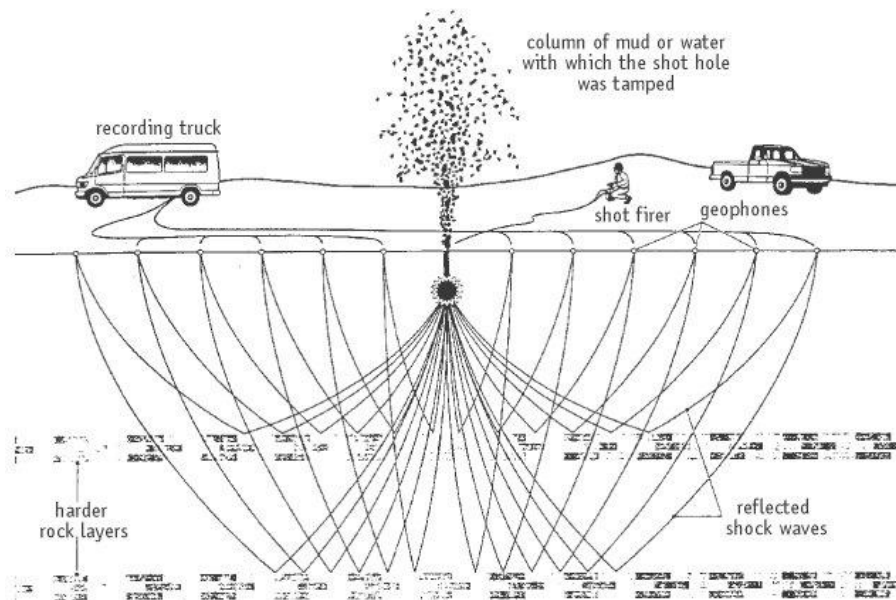
## Basics of the Exploration and Production Business (cont'd)

- Seismic Data and the Understanding of Subsurface Conditions
  - Mapping the Subsurface
  - Use of Explosive Charges and Mapping of Vibrations

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## Basics of the Exploration and Production Business (cont'd)



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## Basics of the Exploration and Production Business (cont'd)

- Understanding of Production and Formations that have been “Proven”
  - Types of Reserves
    - Proven Developed Producing (PDP)
    - Proven Undeveloped
    - Unproven
      - Probable
      - Possible

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## The Reserve Report

- Proved Reserves: Developed/Undeveloped (90%)
- Probable (50%)
- Possible (10%)
- “PV10”
- Reserve Engineering Firms
- Borrowing Base Lending and Advance Rates

## Basics of the Exploration and Production Business (cont'd)

- Acquisition of Leasehold Acreage and Petroleum “Landmen”
  - Leaseholds and Real Property Title
  - Acquisition of Leaseholds and Development of “Prospects”

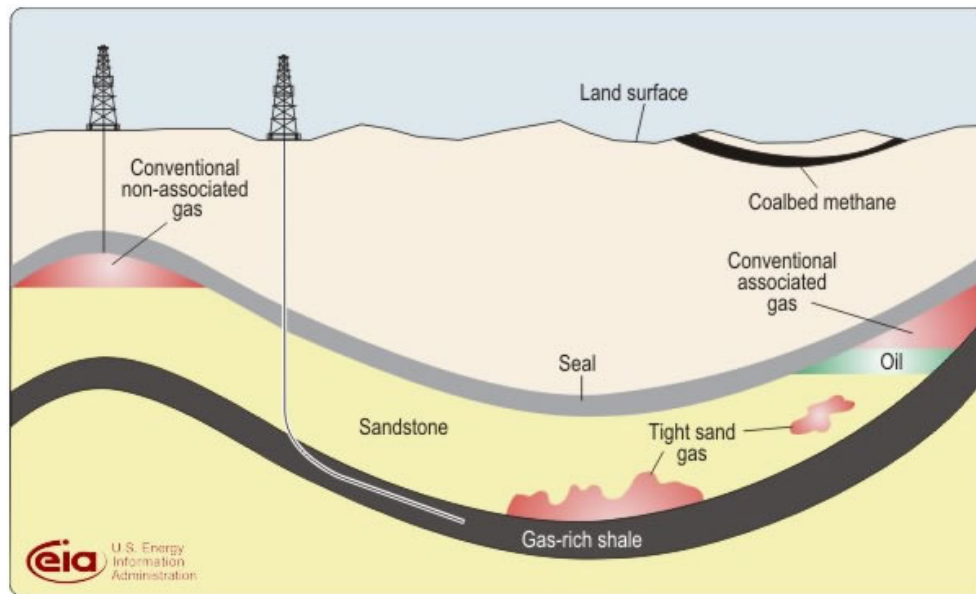
## Production Basics

- Drilling Operations
- Getting Hydrocarbons from the Well Site to Market
- Ongoing Well Operations

## Conventional Drilling vs. “Fracking”

- Conventional Drilling
- Fracking/Horizontal Drilling

## Conventional Drilling vs. “Fracking” (cont’d)



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## The Oil and Gas “Lease”

- Typical Elements of a Lease
  - Primary Term
  - Bonus Rental
  - Delay Rentals
  - Retention of the Lease during Production
    - Production in “paying quantities”

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## The Nature of the Ownership Interest Under the Lease and Related Forms of Conveyance

- Landowner “Royalty” Interest
- Working Interests
- Overriding Royalty Interests
- Farm-Outs and Production Payments

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns

- State Law
  - Fee simple determinable interest. Texas, and likely North Dakota and Pennsylvania.
  - Incorporeal immovable. Louisiana, likely a real right, and therefore not likely a lease or an executory contract, but conflicting case law

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- License. Kansas, Wisconsin, and Minnesota law have held that oil and gas leases are executory contracts subject to Section 365.
- Real property Interest. Oklahoma and Illinois.
- Other states. Ohio cases conflict, Wisconsin and Minnesota case suggest Bankruptcy Code Section 365 requirement for assumption or rejection applies.

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- Federal Law. Most likely a “lease” of offshore lands.

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- Selected Bankruptcy Legal Issues.
  - Code Section 541 (b)(4)—Exclusion of certain interests from “property of the estate”

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- Property of the estate “**does not include**—(4) any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—
- (A) (i) the debtor has **transferred** or has agreed to transfer such interest pursuant to a **farmout agreement** or any written agreement directly related to a farmout agreement; and (ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544(a)(3) of this title; or
- (B) (i) the debtor has transferred such interest pursuant to a **written conveyance of a production payment** to an entity that does not participate in the operation of the property from which such production payment is transferred

## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- Code Section 365 (b) and (d)
- (b) (1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
- (A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;
- (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
- (C) provides adequate assurance of future performance under such contract or lease.

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## The Property Interest Conveyed by a Lease and Bankruptcy Concerns (cont'd)

- (d) (4) (A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—(i) the date that is 120 days after the date of the order for relief; or (ii) the date of the entry of an order confirming a plan.
- (B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for on the motion of the trustee or lessor for cause.
- (ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance. 11 U.S.C. § 365(d)(4).

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## Regulators

- Federal: Bureau of Ocean Energy Management (BOEM) and Bureau of Safety and Environmental Enforcement (BSEE)
- State examples:
  - Texas: Texas Railroad Commission
  - Louisiana: Department of Natural Resources/Office of Mineral Resources
  - California: Division of Oil, Gas and Geothermal Resources (DOGGR)
  - North Dakota: North Dakota Industrial Commission, Department of Mineral Resources, Oil and Gas Division

## Potential Hidden Liabilities

- Environmental and Regulatory Obligations
- Unsatisfied Plugging and Environmental Obligations
- Bonding Requirements



The background image shows a massive construction site. A large crawler crane is positioned on the right, with its boom extending across the top of the frame. In the center, a large circular component, possibly a tunnel boring machine cutterhead, is being transported on a barge or a similar low-profile carrier. The ground is dirt and gravel, with several small vehicles and people visible in the foreground for scale. The sky is overcast.

































# 16,000 Tons: What Do You Get Another Covenant Default Notice in Deeper in Debt

\* With Apologies to Tennessee Ernie Ford





## Coal company bankruptcy filings since 2012

01/23/12	Evergreen Energy	7	\$240M	Delaware	
01/26/12	Larry Addington	11^	\$7.1M	Kentucky	
02/15/12	Alpha & Omega Coal	7	Up to \$1M	West Virginia	
03/29/12	H & D Mining	7	Up to \$50,000	Kentucky	
06/11/12	B&B Coal	7	\$125,750	Kentucky	
06/29/12	Panther Branch Coal	7	\$2.4M	West Virginia	
07/09/12	Patriot Coal	11	More than \$1B	Missouri	
07/11/12	Conshor Mining	7	Up to \$50,000	Kentucky	
09/21/12	Tennessee Classic Coal	11	Up to \$500,000	Tennessee	
10/01/12	Haley Bros. Coal	7	Up to \$10M	Alabama	
11/07/12	King Coal Trucking	11	Up to \$50,000	West Virginia	
02/01/13	Cobra Mining	7	Up to \$50,000	Pennsylvania	
02/01/13	America West Resources	11	\$18.3M	Nevada	
02/14/13	Trinity Coal	11	NA	Kentucky	
02/14/13	Excell Energy and Coal	11	Up to \$50K	Kentucky	
02/19/13	T&T Energy	11^	\$8.5M	Kentucky	
06/28/13	Twin Star Coal	11	\$2.8M	Kentucky	
07/01/13	Detherage Coal Sales	7	\$10,398	Kentucky	
09/23/13	Lily Group	11	Up to \$50M	Indiana	
10/08/13	Valley Mining	7	Up to \$50,000	Ohio	
11/22/13	Manalapan Mining¹	7	\$2.3M	Kentucky	
11/22/13	Left Fork Mining¹	7	\$56,700	Kentucky	
11/22/13	Cloverfork Mining & Excavating¹	7	\$61,609	Kentucky	
11/22/13	Cumberland River Energies¹	7	\$14,000	Kentucky	
11/22/13	B&S Trucking¹	7	\$10,845	Kentucky	
11/22/13	Bennett Resources	7	No assets	Kentucky	
02/07/14	Cobalt Coal	7	\$30,000	West Virginia	
04/07/14	James River Coal	11	Up to \$1B	Virginia	
05/22/14	US Coal*	11^	NA	Kentucky	
05/22/14	Licking River Mining*	11^	NA	Kentucky	
06/27/14	IBCS Mining	11	Up to \$50M	Virginia	
10/08/14	Coal Valley	7	Up to \$50,000	Pennsylvania	
12/01/14	Bumi Investment	15	Up to \$1B	New York	
12/01/14	Bumi Capital²	15	Up to \$500M	New York	
12/01/14	Enercoal Resources²	15	Up to \$500M	New York	
12/03/14	Cline Mining	15	Up to \$100M	Colorado	
02/24/15	Covington Coal²	11	\$1.1M	West Virginia	
04/06/15	Xinergy	11	Less than \$50,000	Virginia	
04/15/15	Grass Creek Coal	11	Up to \$500,000	Wyoming	
05/12/15	Patriot Coal	11	More than \$1B	Virginia	
05/27/15	Birmingham Coal & Coke	11	Up to \$50M	Alabama	
06/03/15	A & M Coal	7	Up to \$500,000	Kentucky	

List may not be comprehensive.  
 ¹ Companies of coal operator Benjamin Bennett and his family.  
 ² U.S. units of Indonesia's PT Bumi Resources Tbk.  
 \* Jointly filed.

^ Later converted to a Chapter 7 case.  
 NA = not available.  
 Sources: SNL Energy, assorted court filings  
 Credit: Cat Weeks



COAL HAS BEEN HIT HARD BY VARIOUS FACTORS





# Peabody Coal (2016)

## A. The Debtors' Declining Financial Performance.

51. Over the past several years, American coal producers have encountered reduced demand and lower coal prices created by sluggish economic growth, an abundance of extremely low priced natural gas and increased regulatory hurdles. This convergence – of marked reductions in volume and pricing – substantially impacted the Company's revenues and cash flows.

### Price Declines

52. Slowing global economic growth drove a wide range of industry prices lower in 2015, resulting in the largest broad resource market decline since 1991. Seaborne coal prices continued to decline due to an oversupply in the global market (e.g., reductions in Chinese imports more than offset supply cutbacks and economic weakness particularly in China).

### Volume Declines

53. At the same time, the market experienced worldwide reductions in the demand for steel (largely tied to China's exporting of steel and drop in the demand for metallurgical coal imports). In 2015, seaborne metallurgical coal demand declined by approximately 15 million tons. In seaborne thermal coal markets, demand declined eight percent as a result of a nearly 75 million ton reduction in Chinese imports, lower European demand and a decline in international liquefied natural gas prices. The overall decline in seaborne thermal demand primarily impacted U.S. exports which were down 41%.

Source: Case 16-42529 Doc 7 Filed 04/13/16 (Bankr. E.D. Mo.)

# Arch Coal Company

27. Despite the many proactive steps the Debtors have taken over the last several years to enhance the efficiency of their operations and to focus on high-return opportunities, the Debtors' highly leveraged capital structure, consisting of more than \$5 billion in outstanding indebtedness and approximately \$360 million in annual debt service, cannot be sustained in the current depressed coal market. The Debtors' operational success is closely linked to global demand for coal-fueled electricity and steel. Over the past several years, a confluence of economic challenges and regulatory hurdles has hobbled the coal industry. In domestic thermal markets, the industry has experienced falling coal demand and an associated decline in coal prices, precipitated by flat U.S. power demand, a surge in low-cost natural gas availability and increasingly burdensome environmental regulations. As a result, generators are expected to retire nearly 13 gigawatts of coal-based capacity in 2015. In metallurgical markets, the industry has suffered from slowing global economic growth, a related decline in global steel production, the start-up of significant new coal mine capacity in Australia and a strong U.S. dollar that has undermined the competitiveness of U.S. producers. As a result of these challenges, several major U.S. coal companies have filed for chapter 11 protection in the last several years, and virtually all are in distress.

Source: Case 16-40120 Doc 3 Filed 01/11/16 (Bankr. E. D. Mo.)

# Alpha Coal Reserves

## THE UNPRECEDENTED MARKET CHALLENGES FACING THE COAL INDUSTRY

10. Shortly after the Massey Acquisition, the coal industry began to face unprecedented market challenges, leading to a historic decline. During the past several years, American coal producers have encountered a confluence of macroeconomic headwinds, competitive pressures and regulatory obstacles that, collectively, have distressed the domestic coal industry. These adverse trends have included: (a) rapidly falling coal prices due to, among other things, the substantially expanded ability of North American energy companies to produce vast quantities of natural gas; (b) weak demand and significant oversupply for both thermal and metallurgical coal due to slower than expected economic growth in both the United States and overseas markets (such as Europe, where the Debtors are the largest exporter of U.S. coal, and China, the largest user of thermal and met coal in the world); (c) the increasing use and government subsidization of renewable energy technologies, both in the United States and abroad; and (d) the imposition of restrictive federal and state regulations on coal producers and operators of coal-fired power plants, which regulations (i) constrain the use of coal to make electricity, (ii) have precipitously reduced domestic demand for thermal coal and (iii) have sharply increased the costs of maintaining regulatory compliance.

Source: Case 15-33896-KRH Doc 5 Filed 08/03/15 (Bankr. E.D. Va)

# Walter Energy

## VII. Events Leading to the Chapter 11 Cases

108. Since 2011, metallurgical coal prices have declined dramatically due to several external pressures, including greatly reduced Chinese import demand, significantly increased sources of seaborne supply and the strength of the U.S. dollar against other currencies in coal producing countries, such as Australia. Prices for both thermal and metallurgical coal declined steadily from 2011 through 2014. The decline intensified in early 2015, with spot prices for metallurgical coal falling below US\$110 per metric ton, down from \$330 per metric ton in Q2 of 2011. Today's benchmark metallurgical coal price for Q3 of 2015 recently settled at \$93 per metric ton.

...

[T]he burden on the Debtors of their funded debt obligations and labor-related liabilities has become unsustainable. The Debtors suffer from crippling legacy labor costs, principally in the form of medical benefits and pension obligations, as well as insupportable hourly labor costs. With cash reserves of approximately \$270 million as of June 30, 2015, the Debtors continue to suffer substantial losses from operations despite the far-reaching cost cuts already taken. As such, the Debtors risk exhausting their liquidity by the end of 2015, given the declining metallurgical coal environment, over \$3 billion in debt, annual interest expense of \$264 million, and the weight of the Company's labor costs and legacy retiree obligations.

Source: Case 15-02741-TOM11 Doc 3 Filed 07/15/15 (Bankr. N.D. Ala.)

# Peabody Two

6. Patriot's feasibility upon emergence from the 2012-13 Restructuring was predicated on assumptions about coal prices that ultimately did not materialize. Notwithstanding the consummation of its prior chapter 11 cases, Patriot, like other coal industry leaders, has faced—and continues to face—strong headwinds as a result of the continued decline in domestic and foreign demand for coal, burdensome environmental regulations, and unsustainable further legacy and other non-operating liabilities. In addition, operational issues relating to a longwall move and a mine collapse at one of the Debtors' mining complexes, Federal, caused Patriot to suffer significant cash shortfalls from its projections.

Source: Case 15-32450-KLP Doc 22 Filed 05/12/15 (Bankr. E.D. Mo.)

So What Is A Creditor or  
Party In Interest To Do?

USE A MAGIC WISH FROM A GENIE'S LAMP TO  
ELIMINATE FRACKING AND COAL'S POLLUTION?

BECOME A PROFESSIONAL POKEMON TRAINER?



**EXTRA! EXTRA!**  
**READ ALL ABOUT IT!**

**CHANGES  
COMING!!**

**NO, KNOW THE ISSUES!**

# WHAT ARE MINERAL RESERVES AND COAL LEASES?

- Are They unexpired leases of non-residential real property? Or
  - Are they Interests in Real Property?
- 
- **GENERAL ANSWER: They are Estates in Real Property!**
  - *See Generally, In re Philbeck, 145 B.R. 870 (Bankr. E.D. Ky. 1992)*

# COAL PERMITS AND RECLAMATION BONDS

Note: Without These, A Debtor Cannot Mine Coal!

# 11 U.S.C. 546 (e)

Coal is a Commodity  
and most Coal is Sold  
Under “Commodity  
Future Contracts”



# REJECTION BEING BOUGHT OUT OF COAL CONTRACTS





# UNION AND RETIREE CONTRACTS: A LARGE ISSUE IN MANY CASES



OHIO.—THE MINING STRIKE IN ROCKING VALLEY—SCENE IN THE TOWN OF EUCLID.—THE STEERING MEN'S RECEPTION OF "BLACKJACK" WORKMEN WHOSE RETURNING FROM THEIR WORK ESCORTED BY A DETACHMENT OF PESHMERGA'S INDEPENDENTS.—FROM A SKETCH BY JOSEPH EDWARDS.—SEE PAGE 221.

# RECLAMATION AND ENVIRONMENTAL CLAIMS: THE LARGEST ISSUE OF ALL





# DOMINO INDUSTRIES?

