

UNIQUE ISSUES IN OIL AND GAS BANKRUPTCIES

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Bankruptcy Bench Bar Conference
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RECENT OIL AND GAS BANKRUPTCY TRENDS

As Oil Prices Fall, E&P Bankruptcy Filings Rise

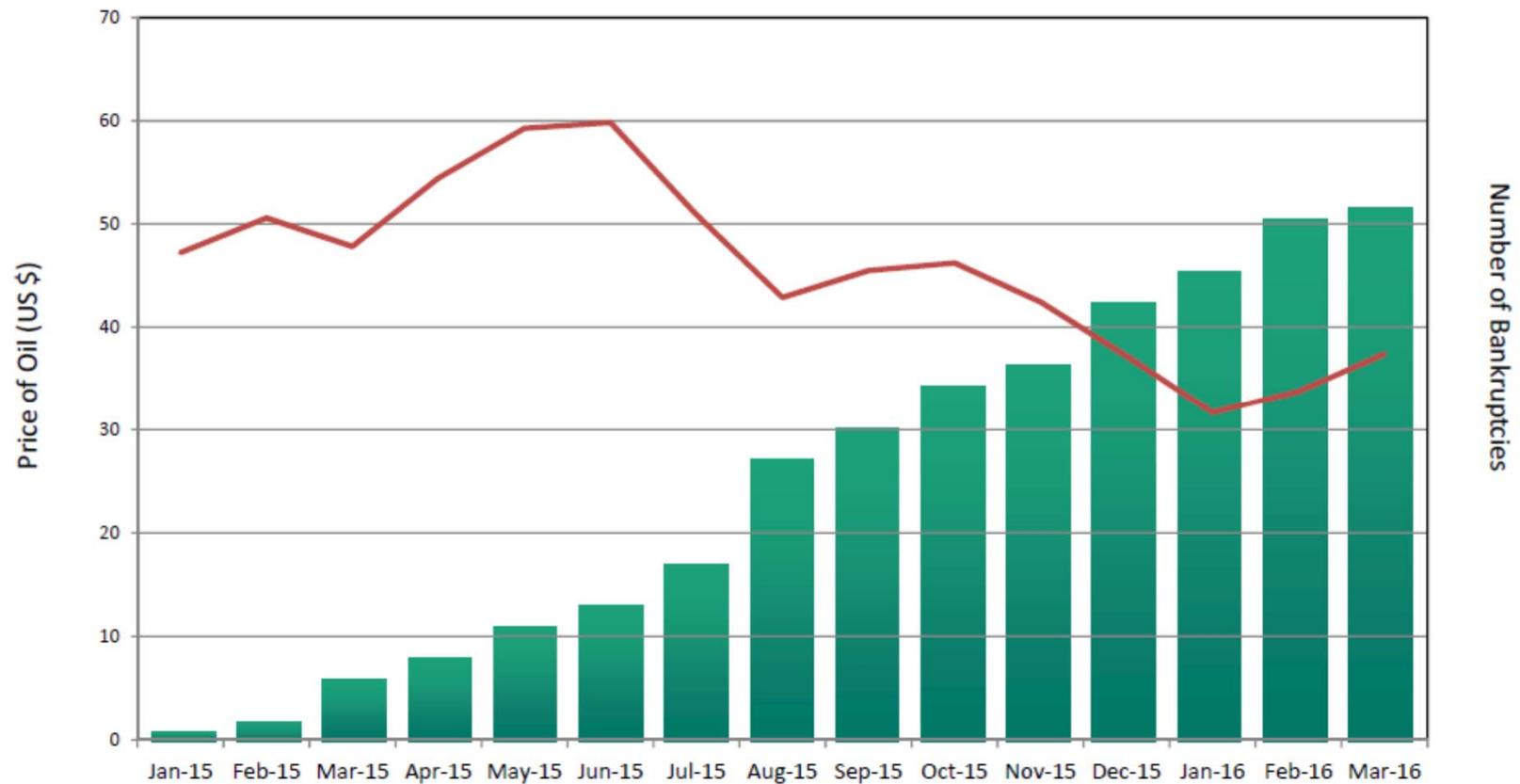
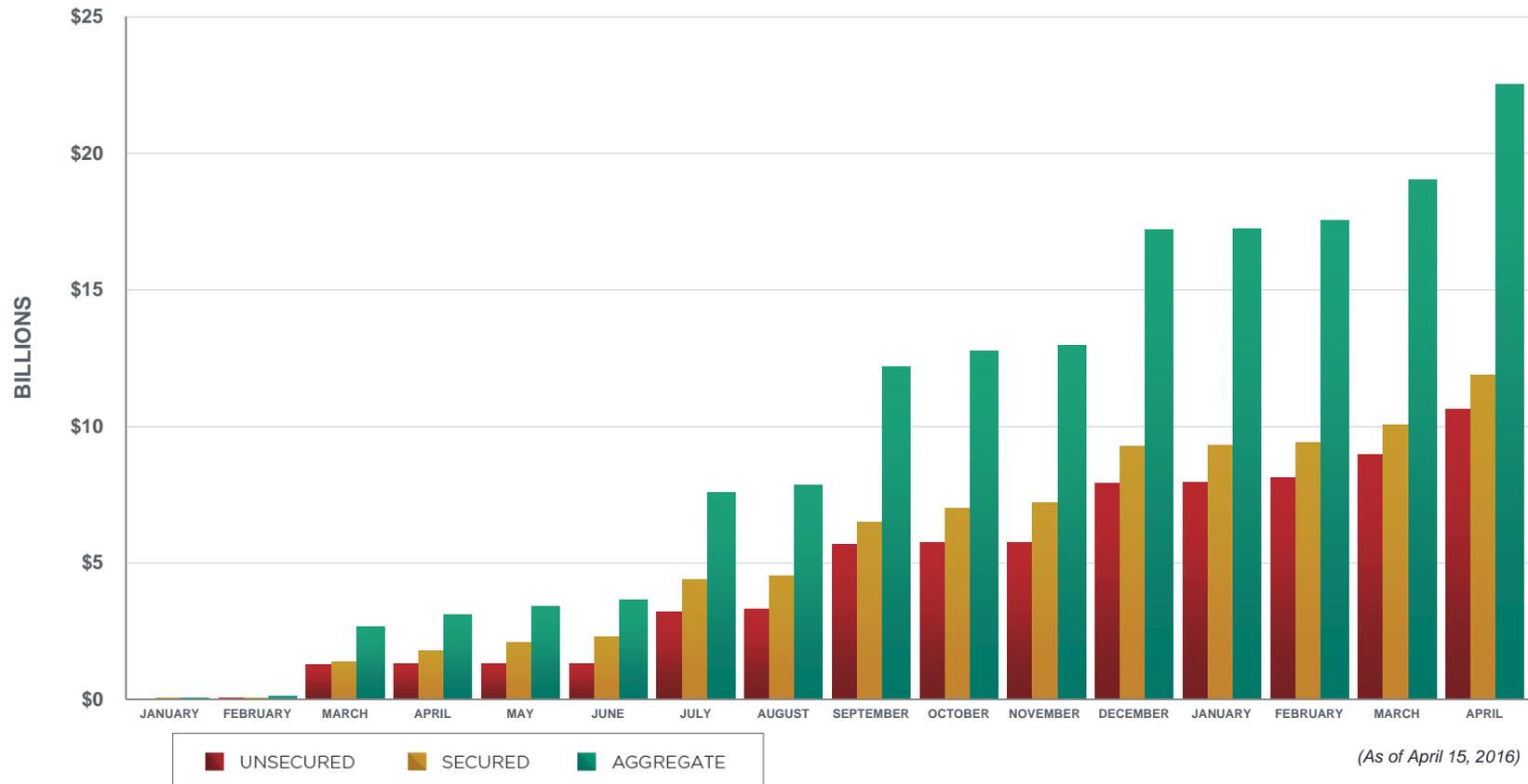


Chart Source: Haynes and Boone

Oil price data from U.S. Energy Information Administration and The Wall Street Journal

Bankruptcy data from Haynes and Boone Oil Patch Bankruptcy Monitor

2015-2016 Cumulative E&P Unsecured Debt, Secured Debt and Aggregate Debt



HAYNES AND BOONE OIL PATCH BANKRUPTCY MONITOR

Distress Factors

- Low commodity prices for sustained period of time
- Lenders facing increased pressure from regulators
- Borrowing bases reduced, triggering mandatory pay down of loans
- Hedges terminating, resulting in significantly reduced liquidity for operators

MIDSTREAM CONTRACTS IN BANKRUPTCY

Issues with rejecting midstream contracts

- E&P debtors often have midstream contracts in place ancillary to oil and gas leases that pose issues with rejection under § 365.
 - Gas gathering/storage agreements & liquefied natural gas (LNG)
 - Pipeline contracts
 - Portions of joint operating agreements may “touch and concern” land
- In some ways, analysis similar to “typical” executory contracts
 - Automatic stay prevents collection of defaulted amounts
 - Counter-party must perform pending assumption/rejection decision
 - Issues with compensation (contract rate versus reasonable value)
 - Prepetition defaults must be cured for assumption
 - May seek to compel assumption/rejection by showing sufficient harm

Issues with rejecting midstream contracts *(continued)*

- Midstream contracts may contain covenants running with land—a property interest, not an executory contract—that are not subject to rejection under § 365
- State law defines property interests, so analysis will be dependent on the state law governing the contracts (not always the venue).
 - *Sabine* (Del.) and *Quicksilver* (SDNY) each involve Texas law
- Texas law requires five elements for covenants to run
 - Covenant must “touch and concern” the land;
 - Covenant must “relate to a thing in existence” or specifically bind successors/assigns;
 - Parties must intend for covenant to run;
 - Successor to the burden must have notice of covenant; and
 - Privity of estate/vertical privity (or of contract/horizontal privity?)

In re Energytec, Inc., 739 F.3d 215 (5th Cir. 2013).

Issues with rejecting midstream contracts *(continued)*

- **Case Study:** *In re Sabine Oil & Gas Corp.* (Bankr. S.D.N.Y.)
- **Background:** Debtor sought to reject an unfavorable gas gathering and dedication agreement governed by Texas law. The contract stated it was binding on successors and assigns and that it constituted a covenant running with land. Counterparty objected claiming that contracts constituted (or contained) covenants running with land (property interests) that could not be rejected or expunged without adversary proceeding.
- **Holding:** Judge Chapman granted motion to reject as exercise of reasonable business judgment but stopped short of ruling that the dedications were not covenants running with a land because of procedural posture. Court indicated evidence suggested the dedication ***was not*** a covenant running with land.

Issues with rejecting midstream contracts *(continued)*

- **Case Study:** *In re Quicksilver Resources, Inc.* (Bankr. Del.)
- **Background:** Purchaser of debtors' assets required rejection of three gas gathering agreements as condition precedent to closing. The agreements contained less compelling language than *Sabine* for intent to run and "touch and concern," and the court likewise tipped hand that would not find covenants running with land.
- Debtor argued that § 363(f) sold assets free and clear of any interests, which included "servitudes," "restrictive covenants," and "any dedication under any gathering, transportation, treating, purchasing or similar agreements that relates solely to any" any contracts to which Debtor is a counterparty. Strong argument because counter-parties did not object to § 363 sale.
- **Outcome:** Settlement shortly after *Sabine* ruling announced

Issues with rejecting midstream contracts *(continued)*

- **Case Study:** *In re Magnum Hunter Resources Corp.* (Bankr. Del.)
- **Background:** Similar posture with Debtor seeking to reject multiple midstream agreements but with a few twists.
 - First, one of the rejection counter-parties is also a bankruptcy debtor—a situation likely to become more common as filings increase. The dual debtor situation raises issues involving the automatic stay and divergent decisions on rejection.
 - Two relevant cases for this situation
 - *In re Old Carco LLC*, 406 B.R. 180 (Bankr. S.D.N.Y. 2009) (“The Debtors were not required to seek relief from the automatic stay in another debtor’s bankruptcy case before exercising their right to reject a contract with that debtor in this case”).
 - *In re Midwest Polychem, Ltd*, 61 B.R. 559, 562 (Bankr. N.D. Ill. 1986) (“[t]he balancing of the equities is especially necessary where, in a case like the instant one, one Chapter 11 debtor formally requests rejection of an executory contract and another Chapter 11 debtor effectively seeks assumption.”).

Issues with rejecting midstream contracts *(continued)*

- **Case Study:** *In re Magnum Hunter Resources Corp.* (Bankr. Del.)
- **Background:** Similar posture with Debtor seeking to reject multiple midstream agreements but with a few twists.
 - Second, some counter-parties have argued that determining property interests in midstream agreements are *Stern* claims over which bankruptcy court lacks constitutional authority to enter a final order.
 - Judge Gross has held that the contested matter involving contract rejection is “core” proceeding. But he—like Judge Chapman in *Sabine*—has reserved judgment with respect to his authority to determine the scope of a counter-party’s property interest (*i.e.*, existence of a covenant running with land) in the procedurally proper adversary proceeding. See Fed. R. Bankr. P. 7001(2).
- **Outcome:** Some disputes settled; separate adversaries filed to address bifurcation issue raised in *Sabine*; currently briefing whether reference should be withdrawn

STATUTORY LIENS IN BANKRUPTCY

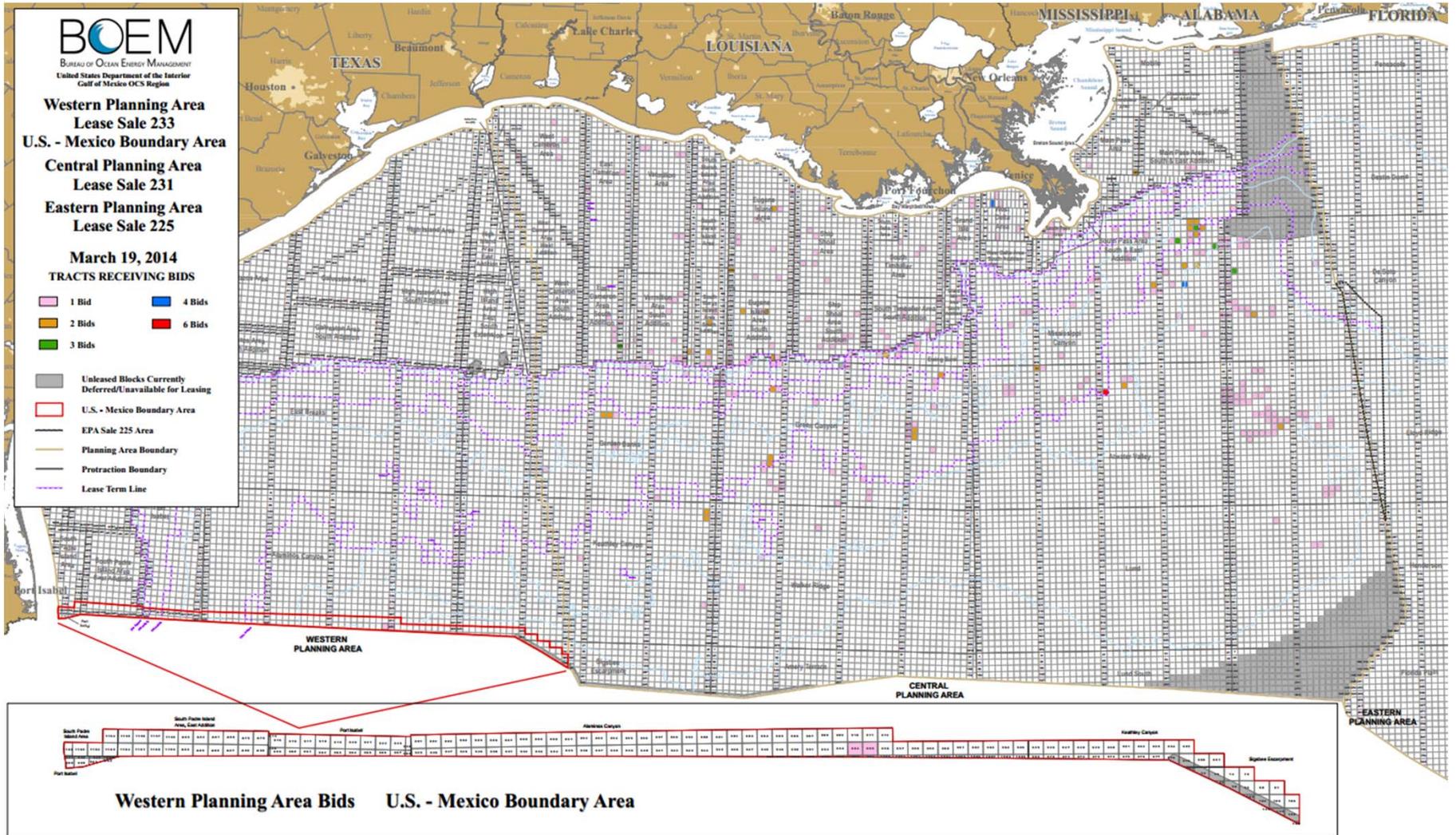
Statutory Oil & Gas Liens

- **Gulf of Mexico (GOM)**
- **Texas**
- **Louisiana**

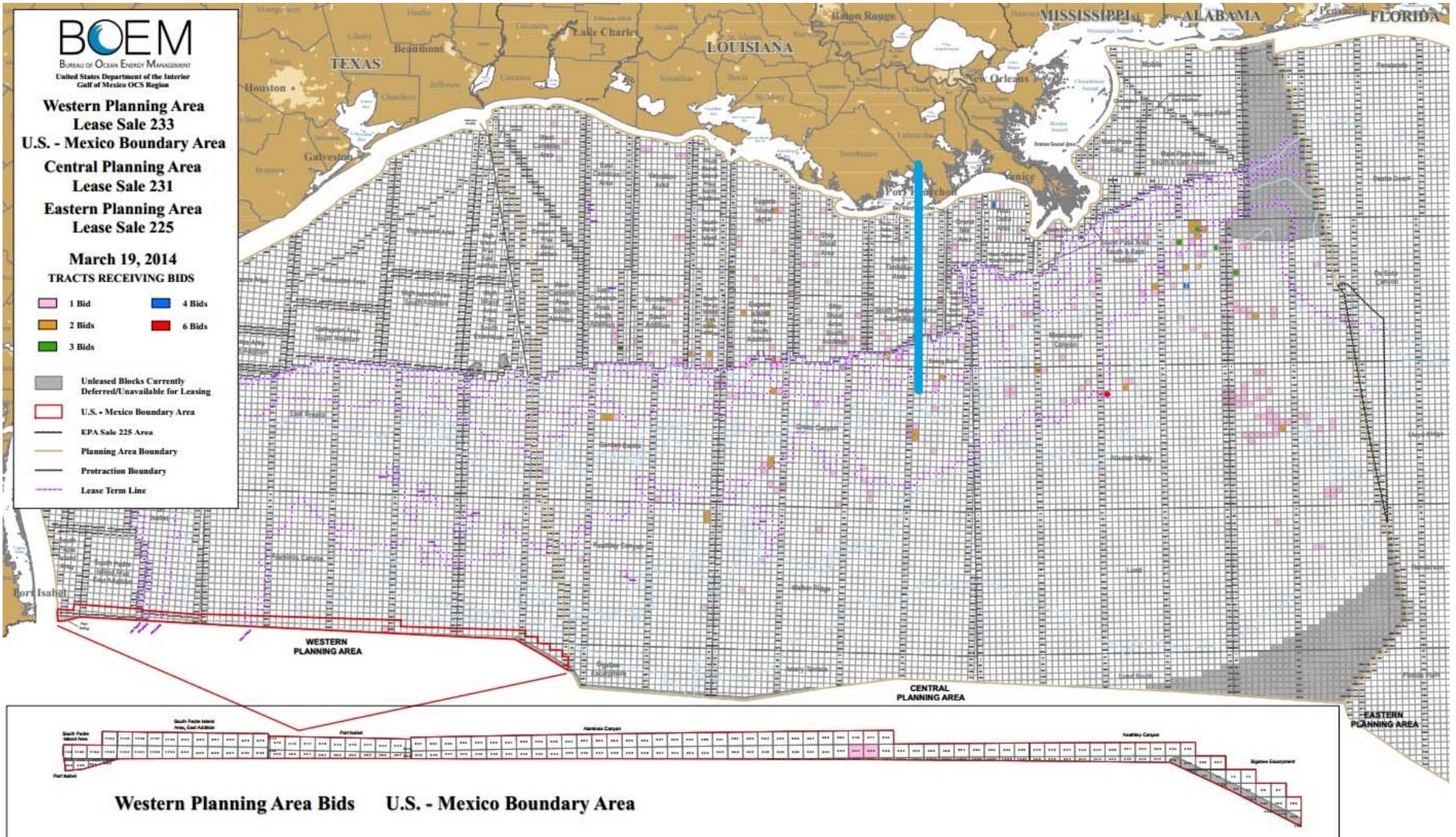
Outer Continental Shelf Lands Act (OCSLA)

choice-of-law provision: 43 USC § 1333(a)(2)(A)

- To the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area.
- *Gardes Directional Drilling v. United States Turnkey Exploration Co.*, 98 F.3d 860 (5th Cir. 1996) (applying Louisiana lien law “as surrogate federal law” under Section 1333(a)(2)(A) of the Act);
- *World Hospitality, Ltd. v. Shell Offshore, Inc.*, 699 F. Supp. 111 (S.D. Tex. 1988) (holding that based on the “Outer Continental Shelf Lands Act’s importation of adjacent-state law to perfect a supplier’s lien on an owner’s mineral leasehold interest... Texas law applies to the perfection of a lien claim on the Outer Continental Shelf adjacent to Texas”).



- **Typically, determination of the adjacent state is fairly straight-forward.**
- **Determination of the nearest county or parish for lien statement recordation purposes can be more complex in some cases.**



Comparison of Texas and Louisiana lien statutes

Defined Terms

Louisiana Oil Well Lien Act
(Louisiana Revised
Statutes, 9:4860 et seq.)
(LOWLA)

“Claimant”

Texas Property Code
Ch. 56

**“Mineral contractor” /
“Mineral subcontractor”**

Comparison of Texas and Louisiana lien statutes

LOWLA

- A “claimant” is a person who is owed an obligation secured by the privilege established by R.S. 9:4862.

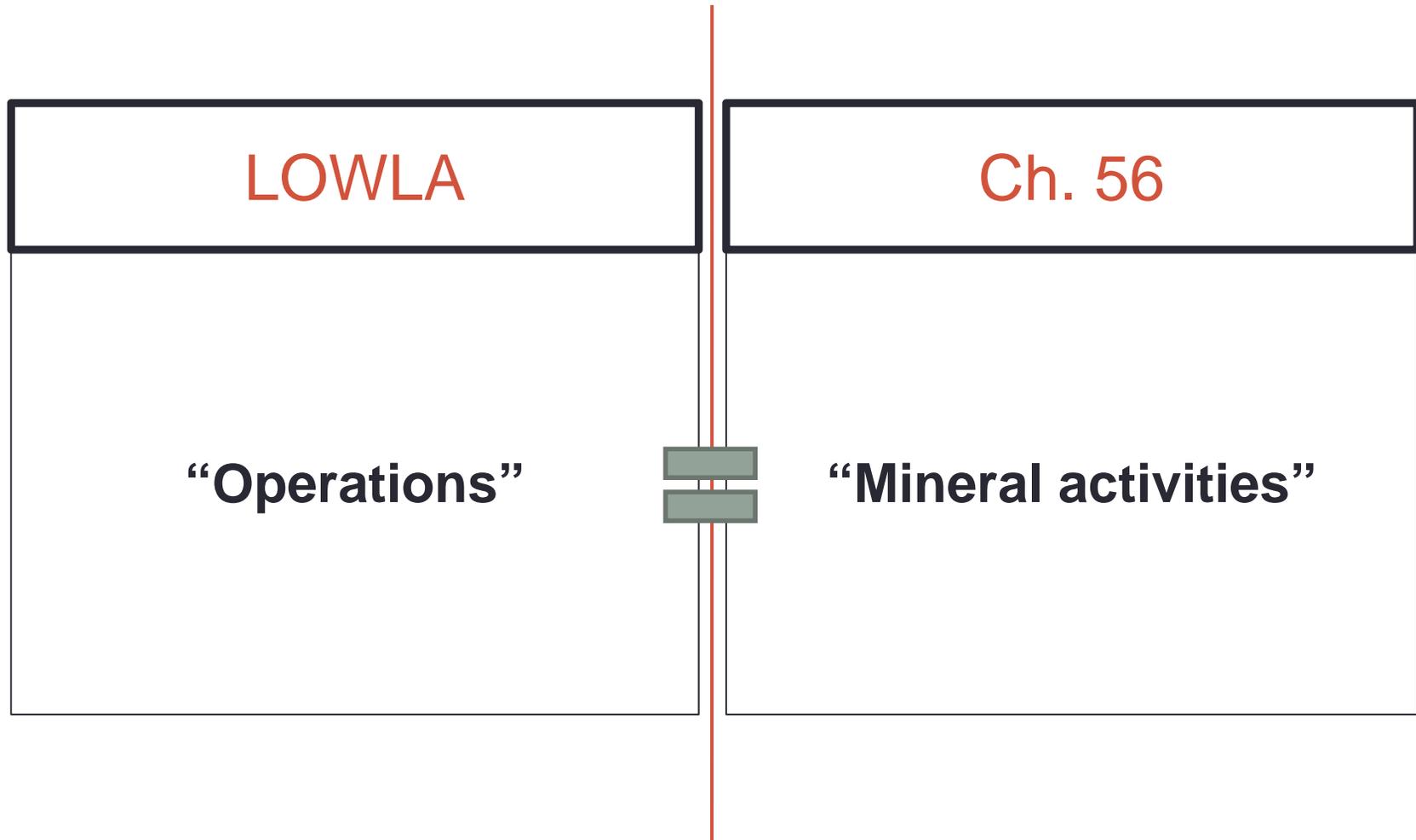
Comparison of Texas and Louisiana lien statutes

Ch. 56

- **“Mineral contractor”** means a person who performs labor or furnishes or hauls material, machinery, or supplies used in mineral activities under an express or implied contract with a mineral property owner or with a trustee, agent, or receiver of a mineral property owner.
- **“Mineral subcontractor”** means a person who:
 - (A) furnishes or hauls material, machinery, or supplies used in mineral activities under contract with a mineral contractor or with a subcontractor;
 - (B) performs labor used in mineral activities under contract with a mineral contractor; or
 - (C) performs labor used in mineral activities as an artisan or day laborer employed by a subcontractor.

Comparison of Texas and Louisiana lien statutes

Defined Terms



Comparison of Texas and Louisiana lien statutes

LOWLA

- **“Operations” are every activity conducted by or for a lessee on a well site for the purpose of:**
 - (i) Drilling, completing, testing, producing, reworking, or abandoning a well.
 - (ii) Saving, treating, or disposing of hydrocarbons or other substances produced from a well.
 - (iii) Injecting substances into the earth to produce or enhance the production of hydrocarbons.
- **“Operations” do not include an activity conducted for the purpose of transporting, handling, processing, treating, or otherwise dealing with:**
 - (i) Liquid hydrocarbons produced or separated at the well site after being removed from a leasehold tank and delivered into a truck, barge, pipeline, or other facility for transportation away from the well site.
 - (ii) Hydrocarbons produced in gaseous form, or produced in association with those produced in gaseous form and not separated at the well site, after being delivered into a pipeline for transportation away from the well site or delivered to a plant at the well site for processing or manufacturing.
 - (iii) Salt water or another waste substance produced in association with hydrocarbons, after it is placed in a truck, rail-car, pipeline, or other means of transportation for disposal away from the well site.

Comparison of Texas and Louisiana lien statutes

Ch. 56

- **“Mineral activities” means digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry.**

Comparison of Texas and Louisiana lien statutes

Defined Terms

LOWLA	Ch. 56
<p data-bbox="459 824 737 878">“Lessee”</p> <p data-bbox="258 915 940 976">“Participating Lessee”</p> <p data-bbox="186 1008 1010 1068">“Non-participating Lessee”</p>	<p data-bbox="1100 915 1881 976">“Mineral Property Owner”</p>

Comparison of Texas and Louisiana lien statutes

LOWLA

- A “lessee” is a person who owns an operating interest.

Comparison of Texas and Louisiana lien statutes

LOWLA

- An “operating interest” is a mineral lease or sublease of a mineral lease, or an interest in a lease or sublease that gives the lessee, either singly or in association with others, the right to conduct the operations giving rise to the claimant’s privilege.

Comparison of Texas and Louisiana lien statutes

LOWLA

- A “participating lessee” is a lessee who is not the operator, but who is personally bound by contract to the operator to pay or reimburse the operator for any part of the obligation secured by the privilege or for any part of the price of the contract of the contractor for whom the operations giving rise to the claimant’s privilege emanate.

Comparison of Texas and Louisiana lien statutes

LOWLA

- A “non-participating lessee” is a lessee who is neither an operator nor a participating lessee. A non-participating lessee does not become a participating lessee because an operator, contractor, or the claimant has the right to recover all or part of the obligation secured by the privilege out of hydrocarbons attributable to the interest of the lessee in the operating interest or from the lessee’s share of the proceeds derived from such hydrocarbons, or out of other property of the lessee.

Comparison of Texas and Louisiana lien statutes

Ch. 56

- **“Mineral property owner” means an owner of land, an oil, gas, or other mineral leasehold, an oil or gas pipeline, or an oil or gas pipeline right-of-way.**

Comparison of Texas and Louisiana lien statutes

Scope of privilege under LOWLA

La R.S. § 9:4863(A)

A. Except as limited by Subsections B, C, and D of this Section, the privilege given by R.S. 9:4862 is established over:

- (1) The operating interest under which the operations giving rise to the claimant's privilege are conducted together with the interest of the lessee of such interest in a:
 - (a) Well, building, tank, leasehold pipeline, and other construction or facility on the well site.
 - (b) Movable on a well site that is used in operations, other than a movable that is only transiently on the well site for repair, testing, or other temporary use.
 - (c) Tract of land, servitude, and lease described in R.S. 9:4861(12)(c) covering the well site of the operating interest.
- (2) Drilling or other rig located at the well site of the operating interest if the rig is owned by the operator or by a contractor from whom the activities giving rise to the privilege emanate.
- (3) The interest of the operator and participating lessee in hydrocarbons produced from the operating interest and the interest of a non-participating lessee in hydrocarbons produced from that part of his operating interest subject to the privilege.
- (4) The proceeds received by, and the obligations owed to, a lessee from the disposition of hydrocarbons subject to the privilege.

Comparison of Texas and Louisiana lien statutes

Scope of Ch. 56

Tex. Prop. Code § 56.003

(a) The following property is subject to the lien:

- (1) the material, machinery, and supplies furnished or hauled by the lien claimant;
- (2) the land, leasehold, oil or gas well, water well, oil or gas pipeline and its right-of-way, and lease for oil and gas purposes for which the labor was performed or material, machinery, or supplies were furnished or hauled, and the buildings and appurtenances on this property;
- (3) other material, machinery, and supplies used for mineral activities and owned by the owner of the property listed in Subdivision (2); and
- (4) other wells and pipelines used in operations related to oil, gas, and minerals and located on property listed in Subdivision (2).

(b) A lien created by performing labor or furnishing or hauling material, machinery, or supplies for a leaseholder does not attach to the fee title to the property.

Comparison of Texas and Louisiana lien statutes

Abella v. Knight Oil Tools, 945 S.W.2d 847 (Tex. App. – Houston 1997)

- The court appointed a receiver to preserve the value of the mineral lienholder's collateral during the pendency of the lien foreclosure lawsuit.
- An argument can be made for the same rationale in a bankruptcy case thus requiring “adequate protection” to be provided by the debtor.

Comparison of Texas and Louisiana lien statutes

Lien Inception Date



**date materials or
labor first furnished**

Comparison of Texas and Louisiana lien statutes

United States v. Century Offshore Mgmt. Corp. (In re Century Offshore Mgmt. Corp.), 111 F.3d 443 (6th Cir. 1997)

PLUGGING AND ABANDONMENT AND DECOMMISSIONING OBLIGATIONS

Regulatory Authorities

Gulf of Mexico 

**Bureau of Ocean Energy
Management (BOEM) /
Bureau of Safety and
Environmental
Enforcement (BSEE)**

Regulatory Authorities

Texas



**Texas Railroad
Commission**

Regulatory Authorities

Louisiana  **Department of
Natural Resources**

Significant P&A issues in recent bankruptcy cases

- ***In re ATP Oil & Gas Corporation***,
Case No. 12-36187, United States Bankruptcy Court, Southern District of Texas
- ***Black Elk Energy Offshore Operations, LLC***,
Case No. 15-34287, United States Bankruptcy Court, Southern District of Texas

In re ATP Oil & Gas Corporation,
Case No. 12-36187, United States Bankruptcy
Court, Southern District of Texas

- Bonding
- Exemptions
- Predecessor liability
- Decommissioning Trust for properties not acquired in 363 sale

Black Elk Energy Offshore Operations, LLC,
Case No. 15-34287, United States Bankruptcy Court,
Southern District of Texas

- Bonds secured by cash collateral
- Government bonds/Private bonds
- P&A escrows in favor of predecessors-in-interest

JOINT OIL AND GAS OPERATIONS IN BANKRUPTCY

Joint Operations in Bankruptcy – Operator as Debtor

- Lien Rights under JOAs
 - Non-operating WI owner may have lien on Operator's interest to secure payment of amounts owed
 - JOA or memorandum of JOA must be recorded in relevant real property records
 - But lien may be junior in priority to other liens or debtor's interest may be small
- Operator's compliance with JOA provisions
 - Replacement of Operator?

Joint Operations in Bankruptcy – Non-Operator as Debtor

- Lien Rights under JOAs
 - Same considerations as when Operator is Debtor (lien priority, ensuring JOA recordation)
- Well Proposals and Non-Consent Provisions
 - Implication of the automatic stay – forfeiture of interest?
- Setoff and Recoupment of JIBs
 - Setoff limited to netting prepetition costs against prepetition production proceeds; relief from automatic stay
 - Recoupment permits netting prepetition costs against postpetition production proceeds; must be part of same transaction

Joint Operating Agreements as Executory Contracts

- Typically considered to be executory contracts

“The Court holds that both Wilson and TXO have continuing obligations under the operating agreements so long as oil or gas are produced from the wells in question and, thus, the operating agreements are executory contracts.”

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

- Covenant running with the land?
 - Unit Agreement may require working interest owners to be parties to Joint Operating Agreement
 - JOA may contain language construing provisions as covenants running with the land

Assumption and Assignment of JOAs in Section 363 Sales

- Check Cure Notice to ensure correct cure amount listed
- Review PSA provisions to determine whether executory contracts can be added/removed from list of assumed and assigned contracts after sale hearing
- Adequate assurance of future performance – determine identity of purchaser/assignee
- If debtor is operator, new operator will need to be designated for operations after closing

Rejection of JOAs

- What happens to working interests?
 - Under Texas law, working interest owners treated as co-tenants
 - “[T]he participating co-tenant is allowed to deduct the costs of production from the gross production, and is required to account to the non-participating co-tenant for only his share of the net production, measured by his interest in the land.” *McCurdy v. Harry L. Edwards Drilling Co.*, 198 S.W.2d 609, 612 (Tex. App.—Galveston 1946).
- Operator may be able to recoup debtor’s share of costs from debtor’s share of production proceeds
 - “[E]ven under Texas law, Enstar’s claim would be characterized as a recoupment because the claim of Buttes for the proceeds is subject *ab initio* to reduction for the very expenses that were required to produce the oil.” *Sec. Pac. Nat’l Bank v. Enstar Petroleum Co. (In re Buttes Res. Co.)*, 89 B.R. 613, 616 (S.D. Tex. 1988)

JOAs and Avoidance Actions

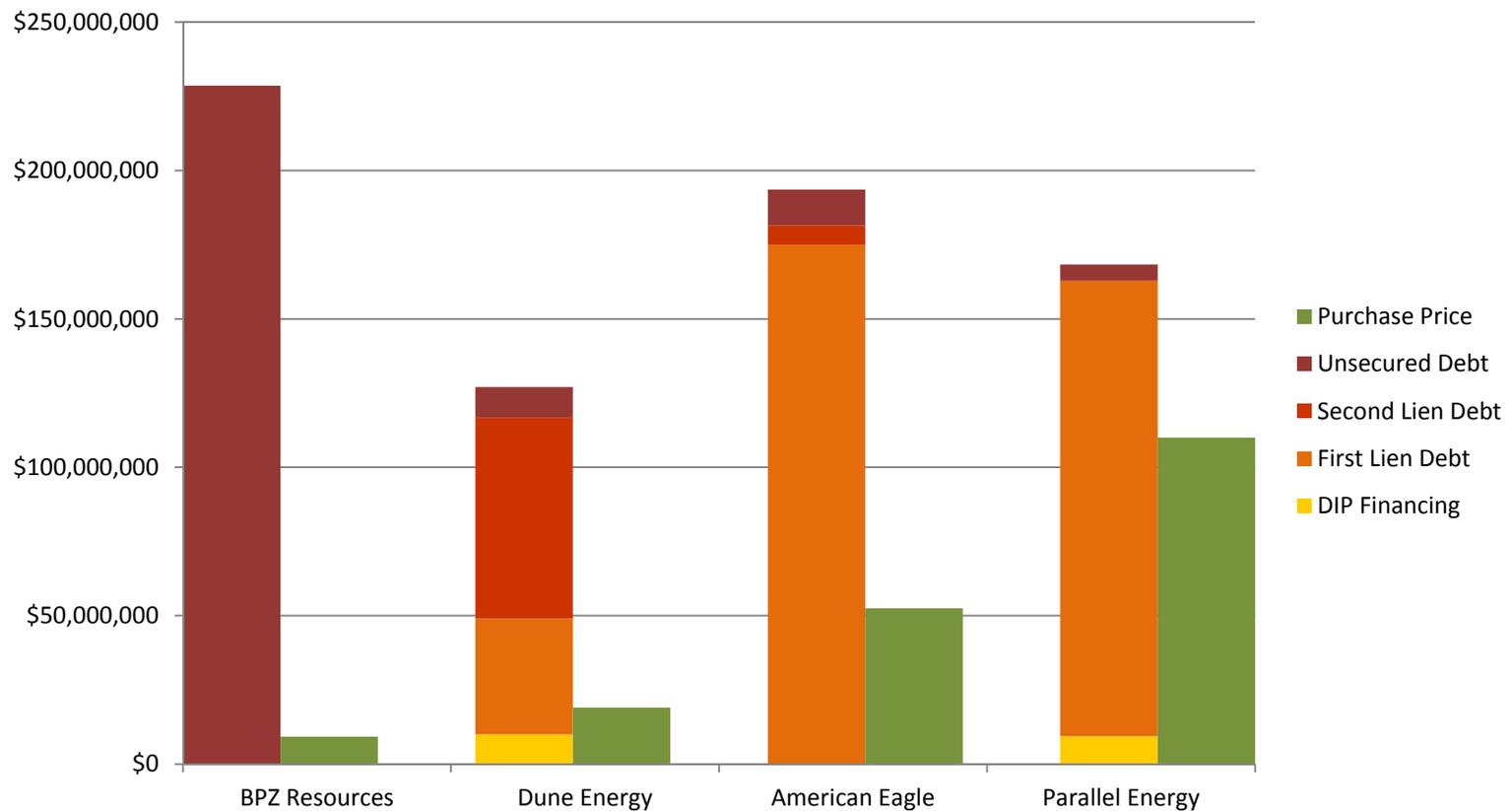
- Prepetition payments under JOA could be challenged as preferences
 - Transfer of production proceeds to non-operator may not be transfer of debtor's interest in property
 - Debtor's payment of JIBs
 - Did payment entitle operator to receive more than it would have received in a hypothetical Chapter 7 case? Maybe not, if facts indicate existence of senior liens or if setoff/recoupment would have been available
 - Also examine historical payment pattern to determine strength of ordinary course of business defense

SECTION 363 SALES, RESTRUCTURING SUPPORT AGREEMENTS, AND OTHER EXIT STRATEGIES

Possible Exit Strategies

- Section 363 Sale of Assets
 - May be accompanied by liquidating plan
- Plan of Reorganization
 - Pre-negotiated/pre-arranged – Restructuring Support Agreement
- Some combination of a sale and a plan
- Conversion to Chapter 7

Comparison of Debt to Purchase Price in Selected Asset Sales



Weighing the Options: Asset Sales

- WBH Energy, LP (1/4/2015, W.D. Texas)
 - No qualifying cash bids; credit bid sale approved on 8/28/2015 and liquidating plan confirmed on 9/4/2015
- Quicksilver Resources (3/17/2015, Delaware)
 - First lien debt of \$273 million, second lien debt of \$825 million, unsecured debt of \$975 million
 - Sale for \$245 million approved 1/27/2016
- ERG Resources, LLC (4/30/2015, N.D. Texas)
 - No qualifying bids; sale process cancelled; plan confirmed 10/30/2015
- RAAM Global Energy Company (10/26/2015, S.D. Texas)
 - No qualifying bids; credit bid sale approved and liquidating plan confirmed 1/19/2016

Weighing the Options: Restructuring Support Agreements

- **Samson Resources Corp. (9/16/2015, Delaware)**
 - Falling commodity prices made RSA unworkable; exclusivity extended to 7/14/2016
- **New Gulf Resources, LLC (12/17/2015, Delaware)**
 - \$135.25 million new first lien notes; second lien notes to be exchanged for 87.5-95% of new equity; subordinated notes to be exchanged for 5-12.5% of new equity
 - Confirmation hearing scheduled on 4/20/2016
- **Swift Energy Company (12/31/2015, Delaware)**
 - \$905.1 million senior notes and \$75 million DIP facility converted to equity; \$330 million prepetition RBL converted to \$320 million exit financing facility
 - Plan confirmed 3/31/2016

End Result in Recent Oil & Gas Bankruptcies

<i>Sale</i>	<i>Reorganization</i>
WBH Energy LP (WDTX) CalDive International (DE) Dune Energy (WDTX) BPZ Resources (SDTX) Quicksilver Resources (DE) Parallel Energy LP (DE) Luca International Group LLC (SDTX) Milagro Oil & Gas (DE) Magnum Green (NDTX)	? Samson Resources (DE) ? Sabine Oil & Gas (SDNY) ✓ Miller Energy Resources (AK) ✓ RAAM Global Energy (SDTX) ✓ Hercules Offshore (DE) ? Magnum Hunter (DE)
<i>Sale / liquidation</i>	<i>Failed sale / reorganization</i>
Black Elk Offshore (SDTX)	ERG Resources (NDTX)

A successful “aspirational” reorganization has yet to be achieved.

QUESTIONS?
