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Oil and Gas Environmental Concerns and Issues

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Oil and gas environmental concerns and issues are becoming more prevalent in bankruptcies due to the present market conditions and depressed commodity pricing affecting the industry. In addition, heightened regulatory oversight pertaining to environmental compliance issues, plugging and abandonment and related decommissioning issues, and financial assurance for such obligations are impacting oil and gas bankruptcies like never before given enhanced public awareness of environmental issues.

On July 14, 2016, the Bureau of Ocean Energy Management ("BOEM"), a sub-agency of the United States Department of the Interior, published NTL 2016-N01, providing updated guidance as to how financial assurance for the protection of the United States Taxpayer would be implemented for plugging and abandonment and related decommissioning. The new policies and procedures associated with NTL 2016-N01, which were enacted following a series of notable oil and gas company bankruptcies, will certainly impact financial assurance obligations pertaining to owners and operators developing oil and gas resources in federal waters. Likewise, the new policies and procedures associated NTL 2016-N01 may impact potential buyers of assets in a bankruptcy and also effect whether a plan of reorganization is confirmable.

This paper presents a high level overview of certain oil and gas environmental concerns and issues impacting bankruptcies currently pending and those anticipated in the near future, with a heavy emphasis on plugging and abandonment and related decommissioning issues.

I. 28 U.S.C. § 959 and *Midlantic*.

Debtors-in-possession, Chapter 11 Trustees, and Chapter 7 Trustees must comply with applicable laws as they navigate bankruptcy cases. Pursuant to subpart (b) of 28 U.S.C. § 959,

> Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any case pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

This provision has been applied to oil and gas operators in an attempt to force compliance with environmental laws and regulations and, in particular, plugging and abandonment and related decommissioning laws and regulations. As such, debtors-in-possession and trustees do not have

a "free pass" in the reorganization or liquidation process to avoid compliance with applicable laws and regulations, even if such avoidance would aid in recovery by creditors and parties in interest.

In addition, the United States Supreme Court has articulated parameters limiting the maneuverability of debtors-in-possession and trustees through its decision in *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494 (1986). Succinctly, the United States Supreme Court mandated that "a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."[1] This simple edict has wide ranging effects and application in bankruptcy cases where environmental issues are impacted.[2] As such, oil and gas environmental concerns and issues, specifically those plugging and abandonment and related decommissioning obligations being addressed in bankruptcy proceedings, have parameters established by United States Supreme Court jurisprudence and additional jurisprudence stemming therefrom which must be considered. Clearly, debtors and trustees cannot simply discard assets without focus on the applicable regulatory obligations before them.

II. Specific Jurisprudence Pertaining to Plugging and Abandonment and Related Decommissioning Obligations.

The United States Fifth Circuit Court of Appeals has applied 28 U.S.C. § 959 and *Midlantic* principles to plugging and abandonment and related decommissioning obligations. In *Matter of H.L.S. Energy Company*, 151 F.3d 434 (5th Cir. 1998), the Fifth Circuit held that "[a] bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety."[3] Citing both *Midlantic* and 28 U.S.C. § 959(b), the court reasoned that, "under federal law, bankruptcy trustees must comply with state law," and "there is no question that under Texas law, the owner of an operating interest is required to plug wells that have remained unproductive for a year."[4] As such, a combination of both federal and state law placed upon the trustee "an inescapable obligation" to address the estate's decommissioning obligations.[5] Taking this analysis to its ultimate conclusion, the Fifth Circuit determined that expenses to remediate plugging and abandonment and related decommissioning obligations were "actual and necessary" expenses of administering the estate, and were therefore to be classified as administrative expenses pursuant to 11 U.S.C. § 503.[6]

The United States Bankruptcy Court for the Southern District of Texas came to a similar conclusion in *In re American Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009). In *American Coastal*, the debtor contended that the decommissioning costs at issue, while incurred post-petition, did not qualify as administrative expenses under 11 U.S.C. § 503(b)(1)(A) because the liabilities accrued pre-petition.[7] However, the court disagreed and determined that

[1] 474 U.S. at 507.
[2] *See* 11 U.S.C. § 554 (addressing the circumstances under which property of the estate may be abandoned).
[3] 151 F.3d at 438.
[4] *Id*.
[5] *Id*.
[6] *Id*.
[7] 399 B.R. at 807.

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