

Decommissioning Oil and Gas Facilities and Bankruptcy Impacts

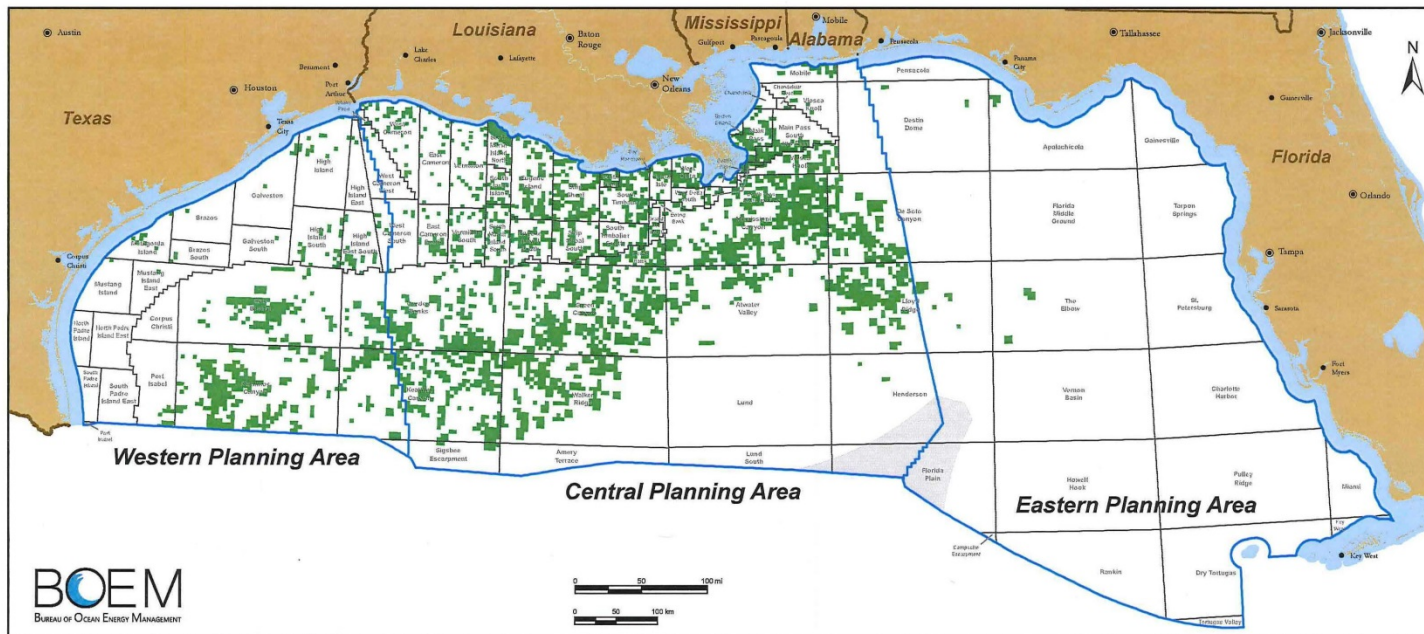
68th Annual Oil & Gas Law Conference
February 17, 2017

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- **The trifecta of trouble**
 1. Aging assets
 2. Downturn in the industry
 3. New financial assurance requirement

- **Bankruptcy – impacts on:**
 1. The debtor oil & gas company
 2. Predecessors/co-operators

**BOEM Gulf of Mexico OCS Region
Blocks and Active Leases by Planning Area
November 1, 2016**



Planning Areas	Total Blocks	Total Acres	Number of Leases	Acres Leased
Western	5,240	28,576,813	574	3,244,769
Central	12,409	66,446,351	2,736	14,396,300
Eastern	11,537	64,357,859	37	200,670
Sub-Totals	29,186	159,381,023	3,347	17,841,739
CPA/EPA Shared Blocks*	(86)		(3)	
Totals	29,100	159,381,023	3,344	17,841,739

Active Lease
 Exclusive Economic Zone
 Northern Portion of the Eastern Gap
 Planning Area Boundary

* CPA and EPA contain 86 shared blocks of which 3 are leased. These blocks are given both a CPA and EPA designation in the data which accounts for a higher block total.

- **2010 – 2014**
 - **200** wells decommissioned each year
- **2015**
 - **145** wells decommissioned
- **2016**
 - Only **64** structures removed

WHY?

- **\$500K to \$4 million**



- **\$4 million** plus **\$2 billion** for North Sea



- **Per-year rise in decommissioning costs**
 - **2015**: Costs were \$2.4 billion
 - **2040**: Expected costs are \$13 billion
 - Increase of 540%
- **More than 600 structures decommissioned in the next 5 years**
- **2000 projects decommissioned between 2021 and 2040 – \$210 billion**

WHY?

- **Decommissioning of large, complex platforms more expensive**
- **Lack of adequate decommissioning technologies**
- **BOEM "idle iron" policy**
 - Unprofitable wells dismantled at end of useful lives

- **Cash-strapped companies delaying spending money on P&A**
- **While number of shut in wells increased in the last year, decommissioning has decreased**
- **Older assets operating at significantly reduced margins – unprofitable to operate.**

- **Several bankruptcies showed companies had inadequate financial assurance**
- **ATP**
 - Pre-bankruptcy BOEM sought to significantly increase ATP bond requirements
 - ATP took on many decommissioning obligations through "**decommissioning trusts**"
 - Still not enough money – Anadarko – predecessor lessor paid **\$100 million** in decommissioning obligations
 - Government feared it (**ultimately taxpayers**) would foot the bill

- **General surety bonds**
 - **\$50K** to **\$3 million** depending on type of activity plus supplemental bonds
- **If company had \$65 million net worth, and did not have P&A liabilities greater than half of net worth, then:**
 - **Exempt** from posting "**supplemental bonds**"

- Changed way BOEM calculates **financial strength** and **reliability**
- Requires more capital and resources per well to cover decommissioning costs

- Aging assets and rising decommissioning costs
- Industry downturn
- New financial assurance requirements will cause drilling and service industries to lose **\$9 billion** in next 10 years

- **Will not allow operator to ignore decommissioning requirements and environmental health & safety obligations**
- **Will not allow bankrupt debtor to abandon wells; obligations continue post-petition**

"A debtor's obligation to expend funds to bring the estate into compliance with a state health and safety law is not contingent upon whether the obligation arose before or after the bankruptcy filing. State law imposes a continuing duty to plug the wells at issue. That continuing state law health and safety duty makes the plugging obligation a post-petition obligation that has pre-petition antecedents. Accordingly, with respect to these environmental liabilities, whether the liability arose pre-petition or post-petition produces an analysis that is superficial. The analysis must focus not on just when the obligation arose, but whether the obligation continues to arise anew with the passage of each day." – *American Coastal*

- Predecessors have obligation to pay any obligation which **"accrued"** even if BOEM approves assignment
- Early court opinions allowed predecessor to contract away that obligation
 - Most do not
- Predecessors who have not paid decommissioning obligations of bankrupt debtor have no bankruptcy claim – **contingent claim**

- Decommissioning obligations during bankruptcy are **"actual and necessary"** expenses which allows an administrative claim
- Any predecessor who actually pays for P&A obligations can have administrative claim
- ATP – converted to Chapter 7
 - Anadarko, through its administrative claim, only recovered **1% of \$100 million** it spent

- ***Black Elk Energy Offshore*** – excellent example
 - Merit Management Partners – assigned leases to Black Elk
 - PSA – \$60 million put in P&A escrow and Merit got a security interest in the escrow
 - Merit retained right to come in and conduct P&A if government required and Black Elk failed
 - Got contractor to agree to "fixed price" for conducting P&A
 - Black Elk to conduct P&A, but if unable, issue promissory notes to Merit for amount spent from fund
 - Merit secured new promissory notes by cash collateral held by third party bonding companies
 - Merit then reimburse P&A escrow from money obtained from bonding company

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