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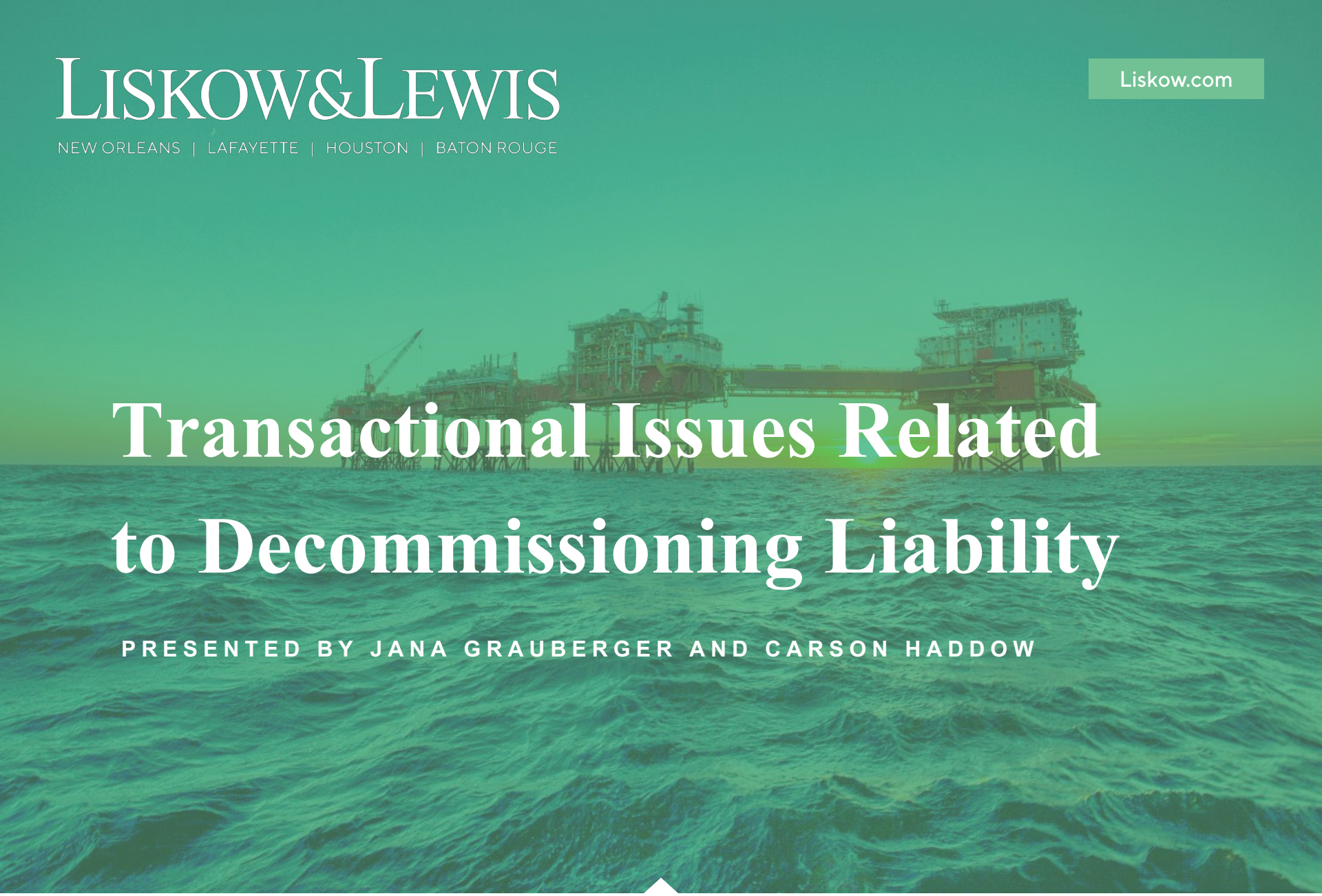

Transactional Issues Related to Decommissioning Liability

PRESENTED BY JANA GRAUBERGER AND CARSON HADDOW

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Setting the Scene

Wham!

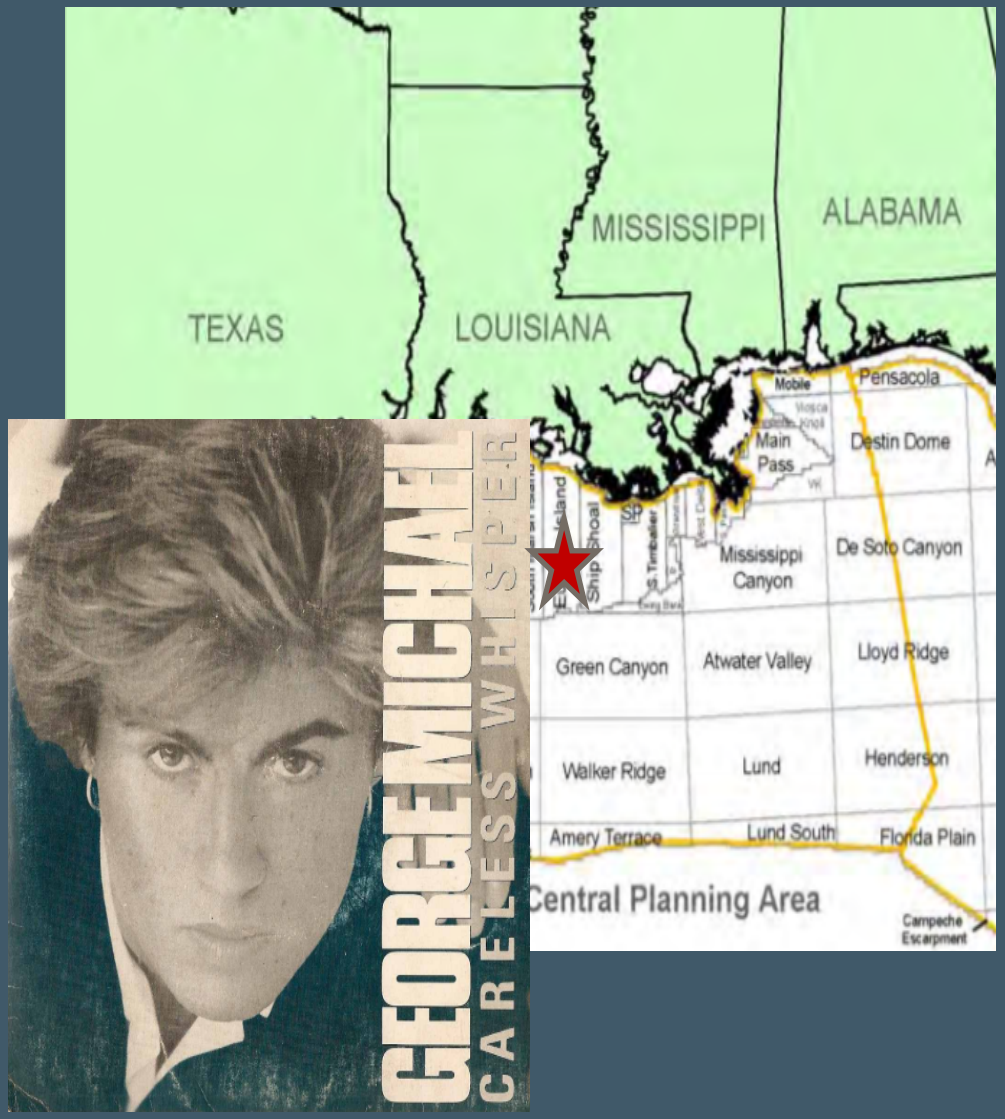
1985 – Super Major leases federal offshore block to develop its **Wham! Prospect**

SM drills wells #1, #2, #3 and installs 2 platforms

2005 – SM assigns to Big Independent #1 and Big Independent #2

2015 – BI#1 assigns to Mom&Pop, M&P and BI#2 drill well #4 and M&P is designated operator of the lease

2016 – M&P enters bankruptcy, lease expires.



Scenario #1

- BSEE orders BI#1 to decommission lease
- **Can BI#1 insist that BSEE go first to BI#2, who was an interest owner at the time the lease expired?**
- **No.** *See Anadarko Petroleum Corporation*, 187 IBLA 77 (2016); *Devon Energy Production Co., L.P.*, 188 IBLA 268 (2016) (IBLA ruled that "[w]here at least one assignee of an [OCSLA] lease has failed to perform its decommissioning obligations under the lease, [BSEE] does not err in holding former lessees jointly and severally liable.")
- **Is BI#1 required to decommission final well drilled by M&P and BI#2?**
- **No.** 30 CFR 250.1702 (accrue obligations when you drill, install, or become lessee/operating rights owner on a lease with existing wells, etc.); 30 CFR 556.710 (liability after assignment for accrued obligations)

Scenario #1

- **Who, if anyone, can BI#1 obtain reimbursement for portion of decommissioning costs?**
  - **SM – no,** BI#1 agreed to assume decommissioning obligations/indemnify SM for same in PSA, Farmout, etc.
  - **BI#2 – probably,** under JOA, each party is liable for its proportionate share of accrued decommissioning obligations, but BI#2 may argue:
    - JOA terminated when lease expired
    - No liability beyond its proportionate share, i.e., not liable for any portion of M&P's share
    - No mechanism via JOA for BI#1 to effectuate JOA JIB provisions b/c not operator under the JOA
- **Assume that when SM assigned to BI#1, it agreed to retain liability for decommissioning obligations, attached to PSA exhibit listing existing wells, platforms, and facilities, scope of work, and estimated decommissioning costs. A hurricane blows through GOM in 2015 prior to decommissioning, costs to decommission exponentially higher. Is SM liable to BI#1 for increased costs?**
- **Maybe not.** *Mariner Energy, Inc. v. Devon Energy Prod.*, 690 F. Supp. 2d 558 (S.D. Tex. 2010) (Mariner not liable for increased decommissioning costs due to hurricane damage even though parties' agreement clearly stated that costs could be higher than estimates).

Scenario #2

- BSEE orders SM to decommission lease.
- **Is SM liable for decommissioning of all wells/platforms on lease?**
- **Maybe yes, maybe no.** If SM retained any RTI, i.e., operating rights assignment, farmout, etc., then SM has liability for all. If SM assigned all RTI to BI#1 and BI#2, then SM is liable for wells drilled and platforms installed during its period of ownership only.

Scenario #3

- BSEE orders BI#2 to decommission lease.
- **Assume lease originally held 50/50 by SM#1 and SM#2. BI#2 acquired interest from SM#2. Can BI#2 obtain reimbursement from BI#1?**
- **Yes.** *See Seagull Energy Inc. v Eland Energy, Inc.*, 207 S.W.3d 342 (Tex. 2006) (Eland remained liable for obligations under JOA after assignment absent release).

PSAs, etc.

Divestiture Issues

- Protection for the seller against regulatory demands for decommissioning or performance of other obligations
- A pure indemnity from the buyer is only as good as the creditworthiness of the buyer at the time the obligation is owed
- Security for an indemnity obligation may take a number of forms
- Most forms of security tie up the capital of the buyer and may lead to negotiations as to reductions in the cash purchase price

Security: LC or Performance Bond

- Letter of Credit furnished by a US bank or bank guarantee furnished by an international bank
  - Typically has a limited term with an evergreen feature with the ability of the beneficiary to draw down if the LC is not renewed
  - Buyer would likely furnish collateral as well as pay an annual LC fee
- Payment and Performance Bond furnished by a credit-worth bonding company
  - Typically not term limited
  - Buyer would likely furnish collateral and pay a bond fee (either once up front or annual fee)

Security: Escrow Agreement or Direct Collateral

- Escrow Agreement with bank as trustee
  - Escrow may be fully funded at closing or funded over time
  - Often accompanied by a security agreement (in the event the escrow would be held as property of a bankrupt estate) and secured by filing a financing statement and obtaining control via a DACA
- Direct Collateral from the Buyer or an Affiliate
  - Security agreement incumbering personal property or mortgage/deed of trust encumbering real property
  - May require periodic actions to preserve the collateral (continuations of UCC financing statements; re-inscription of Louisiana mortgages)

Guarantee: General Considerations

- Parent Company Guarantee
  - A guarantee is not technically collateral security as it depends upon the credit worthiness of the parent
  - It does offer another source of repayment beyond the assets of the buyer
- Whichever collateral is requested, be aware of the prior liens, mortgages, and other security rights in favor of lenders
- Search BOEM, parish, and county records and filings with the Secretary of State of the jurisdiction of formation of the buyer

BOEM Bonding/Financial Assurance and Other Issues

- Bond riders, decommissioning trusts, etc. – issues with reliance on government security
- Timing/Closing Condition posting of substitute bonds or other financial insurance in order to obtain prompt release of existing security
- Consents – designated operator

JOAs

Decommissioning After Operator Bankruptcy

- Typical JOAs provide that the operator will decommission lease infrastructure and each party will bear a share of the costs in proportion to its participating interest
- What happens when the operator goes bankrupt?
- Issue 1: No party has clear responsibility to perform decommissioning under the JOA
- Issue 2: A party who steps up to perform decommissioning may end up bearing the share of costs attributable to the bankrupt party
- Parties will want to clearly address this scenario in the JOA or come to an agreement on cost allocation before decommissioning begins

Responsibility for Bonding

- In light of recent developments in the BOEM financial assurance program, bonding is at the forefront of parties' minds
- The 2015 AAPL Model Form Operating Agreement provides that bonds are to be paid out of the joint account
- Bonding obligations can be significant, operator should be careful that it does not get stuck with responsibility for entire obligation

Decommissioning Liability After Assignment

- Post-*Seagull*, parties are careful to stipulate that they are responsible only for decommissioning obligations accrued pre-assignment:

  "The transferor shall not be responsible for any obligations, debts, or liabilities under this Agreement, which accrue or are incurred by the Parties on or after the effective date of that Transfer of Interest."

- In order to mitigate risk of assignees' default; parties may incorporate provisions making assignors liable for obligations accruing post-assignment, subject to requirement of exhaustion of remedies against defaulting assignee
- 2015 AAPL Model Form Operating Agreement provides an alternative based on the assignee's financial capability; if assignee is financially capable at time of assignment, assignor is only responsible for pre-assignment accrued liability

JOA Term Issues

- The JOA will often be the only contractual relationship between parties faced with a decommissioning order, *i.e.* if one of the parties is a predecessor in title to a now-bankrupt owner
- The party who performs the decommissioning will seek reimbursement from co-owners and possibly predecessors in title
- If JOA has terminated, for example due to lease or unit termination, contractual relationship between the parties will evaporate and decommissioning party will have no recourse against prior JOA partners
- To prevent this, JOA should not terminate until all decommissioning obligations are satisfied, and parties should remain liable for accrued obligations after the JOA terminates:

  "This Agreement shall remain in effect so long as a Lease remains in effect and thereafter until (a) all wells have been abandoned and plugged or turned over to the Parties owning an interest in the Lease on which the wells are located. . . Termination of this Agreement shall not relieve a Party of a liability or obligation accrued or incurred before termination and is without prejudice to all continuing confidentiality obligations or other obligations in this Agreement."

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Thank you

FOR YOUR TIME