

Unplugging the Fifth Circuit’s Abandonment Problem: A Reexamination of the *Midlantic* Exception in Offshore E&P Cases

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I. INTRODUCTION

Beginning in spring 2014, oil prices began a prolonged, significant drop from over \$100 per barrel to below \$30 per barrel in January 2016. Since May 2015, oil has remained below \$60 per barrel. The impact on oil and gas companies—specifically offshore exploration and production (E&P) companies—has been devastating. From the beginning of 2015 through October 2016, more than 213 North American oil and gas companies filed for bankruptcy.¹ When an offshore E&P company fails, one of the most significant questions that must be answered is how the company’s decommissioning or plugging and abandonment (P&A) obligations will be met. Such liabilities are significant—as of January 2017, the estimated net present value of P&A liabilities in the Gulf of Mexico alone exceeds \$23 billion. These liabilities also pose a significant financial risk to U.S. regulatory agencies who have obtained less than \$589 million in posted bonds to secure these claims.²

This Article will examine how a judicially created public policy limitation to the abandonment powers provided under Bankruptcy Code § 554³ espoused by the Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection*⁴ has deprived E&P debtors of the ability to control their own destinies in chapter 11 cases. Section 554(a) of the Bankruptcy Code provides that “[a]fter notice and

1. See David Hunn, *Woe in the Oilfield: 213 Companies Have Now Declared Bankruptcy*, FUELFIX (Oct. 25, 2016), <http://fuelfix.com/blog/2016/10/25/213-oil-companies-have-declared-bankruptcy-how-hard-it-is-to-be-an-oilfield-service-company/>.

2. See Annie Gally, *Gulf of Mexico: Shelf Life*, OIL & GAS INV. (Jan. 5, 2017), <https://www.oilandgasinvestor.com/gulf-mexico-shelf-life-1456941#p=full>.

3.

Section 554 of the Bankruptcy Code provides a mechanism by which the bankruptcy trustee may abandon property if it is not needed by the estate and its retention serves no purpose in effectuating the goals of the Bankruptcy Code. The section sets a standard for determining property that may be abandoned: Property may be abandoned if it is burdensome to the estate or of inconsequential value and benefit to the estate.

5 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 554.01 (16th ed. 2017).

4. 11 U.S.C. § 554 (2010); *Midlantic Nat’l Bank v. N.J. Dep’t of Env’tl. Prot.*, 474 U.S. 494 (1986).

hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.”⁵ Ultimately, the *Midlantic* Court held that a bankruptcy court did not have the power to authorize the abandonment of hazardous properties without formulating conditions that will adequately protect the public’s health and safety.⁶ This exception to the abandonment power vested in the trustee by § 554 is intended to be narrow. The question becomes: how did the narrow *Midlantic* exception become the lynchpin in a broad priority-shifting rule depriving offshore oil and gas debtors of the ability to control their own destinies in a chapter 11 case?

Part II examines the *Midlantic* opinion and subsequent cases that have misapplied the *Midlantic* holding to create an administrative expense priority classification for P&A liabilities. Part III examines the scope and nature of P&A liabilities and their proper treatment under the Bankruptcy Code. Part IV examines existing policies that, if properly enforced, could more adequately address the mounting P&A liabilities left unresolved by failing E&P companies. Part V concludes with a call to reconsider a series of judicially created public policy exceptions to the Bankruptcy Code’s carefully constructed restructuring scheme.

II. OFF-COURSE AND ADRIFT: JUDICIAL POLICY-MAKING AND PLUGGING AND ABANDONMENT LIABILITY

The ripple effect of *Midlantic*, a case involving real property situated on the Atlantic Coast, has been felt by offshore E&P debtors with wells and platforms throughout the Gulf of Mexico. Although the *Midlantic* Court framed its decision as creating a “narrow” exception to a trustee’s abandonment powers under Bankruptcy Code § 554, the Fifth Circuit has applied the *Midlantic* exception broadly, which has resulted in a judicially created priority class of environmental claims in E&P cases. In offshore E&P cases where such claims can exceed tens of millions of dollars, the creation of this priority class of claims poses a significant threat to the administration of offshore E&P chapter 11 cases.

A. *Midlantic: Abandon (Ship)?*

The ideological bedrock supporting the treatment of P&A liability as an administrative expense is found in the Supreme Court’s decision in *Midlantic*. The holding set forth therein, though purportedly narrow, has

5. 11 U.S.C. § 554(a).

6. *Midlantic*, 474 U.S. at 507.

had a broad impact in shaping the treatment of P&A obligations in offshore E&P bankruptcies. Because the *Midlantic* opinion weighs heavily on this analysis, an in-depth review of the opinion is warranted.

In *Midlantic*, the debtor was in the business of processing waste oil at facilities in New York and New Jersey and operated a facility in New Jersey pursuant to a permit issued by the New Jersey Department of Environmental Protection (NJDEP).⁷ When NJDEP discovered the debtor had accepted contaminated oil and was operating in violation of its permit, NJDEP ordered the debtor to cease operations while the parties negotiated a cleanup of the contaminated site.⁸ During the negotiation process, the debtor filed a chapter 11 petition for reorganization.⁹ The next day, NJDEP issued an administrative order requiring the debtor to decontaminate the site.¹⁰

During the bankruptcy proceeding, an investigation into the debtor's New York facility found that the debtor had also accepted and stored contaminated oil in that location, and that the contaminants were leaking from the storage containers.¹¹ Meanwhile, the debtor's chapter 11 case was converted to a chapter 7 proceeding and a trustee was duly appointed.¹² In evaluating the debtor's assets, the chapter 7 trustee determined that the mortgages exceeded the property's total value and any cost to remediate the environmental contamination would be a net burden to the debtor's estate.¹³ As a result, when efforts to market and

7. *Id.* at 496-97.

8. *Id.* at 497.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* Chapter 11 of the Bankruptcy Code provides an opportunity for a debtor to reorganize its business or financial affairs or to engage in an orderly liquidation of its property either as a going concern or otherwise. 7 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 1100.01 (16th ed. 2017). Chapter 7, colloquially known as "straight bankruptcy," is the "operative" chapter of the Bankruptcy Code that normally governs liquidation of a debtor. Liquidation is a form of relief afforded by the bankruptcy laws that involves the collection, liquidation, and distribution of the nonexempt property of the debtor and culminates, if the debtor is an individual, in the discharge of the liquidation debtor. 6 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 700.01 (16th ed. 2017). Fundamentally, the primary distinction between chapter 11 and chapter 7 is that, under chapter 11, the debtor remains in control of its assets as a "debtor-in-possession," whereas in chapter 7 cases, the liquidation is administered by a court appointed fiduciary, the chapter 7 trustee.

13. *Midlantic*, 474 U.S. at 497.

sell the properties failed, the trustee moved to abandon¹⁴ both properties pursuant to § 554 of the Bankruptcy Code.¹⁵

Both New York City and the State of New York (collectively, New York) objected to the chapter 7 trustee's proposed abandonment of the New York facility and offered a two-pronged public policy argument against abandonment: (1) abandonment would pose a threat to public health and safety, and (2) abandonment would violate state and federal law.¹⁶ Specifically, New York pointed to 28 U.S.C. § 959(b)'s requirement that a trustee manage and operate the property of the estate in accordance with applicable state law.¹⁷ The bankruptcy court rejected these arguments and approved the abandonment, observing that the government would be in a better position, relative to the trustee or creditors, to protect public health and safety.¹⁸

After successfully abandoning the New York facility, the trustee sought an order approving abandonment of the New Jersey facility.¹⁹ Again, the abandonment was approved by the bankruptcy court over the objection of NJDEP, which appealed directly to the Third Circuit Court of Appeals.²⁰

On appeal, the Third Circuit reversed the bankruptcy court's decision, declaring that Congress intended certain state laws and equitable interests that protect the public interest to prevail over a trustee's abandonment power.²¹ The chapter 7 trustee next appealed to the United States Supreme Court. Upon granting *certiorari*, the Supreme Court faced a narrow issue: does § 554(a) of the Bankruptcy Code authorize a trustee in bankruptcy to abandon property in the face of state laws designed to protect public health and safety?²² In a 5-4 decision, the Supreme Court held that it does not.²³

Arguing against the holding of the Third Circuit, the trustee reasoned that if Congress had intended to limit a trustee's abandonment power, such limitations should be expressly stated in the Bankruptcy

14. "Abandonment is the release from the debtor's estate of property previously included in the estate." *Id.* at 508 (Rehnquist, W., dissenting).

15. *Id.* at 497 (majority opinion).

16. *Id.* at 498.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 498-99.

21. *Id.* at 499.

22. *Id.* at 496.

23. *Id.* at 504.

Code.²⁴ Indeed, the trustee pointed out that Congress had provided certain express exceptions and limitations to various other powers granted to trustees under the Bankruptcy Code.²⁵ Given that Congress had provided such explicit limitations elsewhere, the trustee argued, no similar exception or limitation should be read into § 554.²⁶ The Court disregarded this contention, distinguishing what it called “firmly established” exceptions to abandonment under § 554 from other provisions of the Bankruptcy Code.²⁷

Writing for the majority, Justice Powell crafted a public policy exception to one of the most significant express powers granted to trustees and debtors-in-possession under the Bankruptcy Code. The Court held 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.²⁸ The Court explained that when Congress enacted § 554 of the Bankruptcy Code, there were established restrictions on a trustee’s abandonment power; therefore, the restrictions were “presumably included” in § 554, although not explicitly stated.²⁹

The Court found additional support for its holding in 28 U.S.C. § 959(b), which mandates that a trustee manage and operate the debtor’s property in accordance with state laws.³⁰ Because § 959(b) requires that trustees adhere to state laws, the Court reasoned that Congress could not have intended for the Bankruptcy Code to preempt all state laws constraining a trustee’s abandonment powers.³¹

Finally, the Court turned its attention to Congress’ environmental concerns, noting the “goal of protecting the environment against toxic pollution.”³² Given the congressional emphasis on protecting the environment and the public from imminent and substantial endangerment, the Court was not convinced that Congress would be willing to permit a trustee to abandon hazardous properties.³³

Ultimately, the *Midlantic* Court held that the bankruptcy court did not have the power to authorize the abandonment of hazardous properties

24. *Id.* at 504.

25. *Id.* at 502.

26. *Id.* at 504.

27. *Id.*

28. *Id.* at 506-07.

29. *Id.* at 501.

30. *Id.* at 505.

31. *Id.*

32. *Id.*

33. *Id.* at 506-07.

without formulating conditions that will adequately protect the public's health and safety.³⁴ Importantly, the Court left open the question of whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself.³⁵

Notwithstanding the resulting broad ramifications, the *Midlantic* Court intended this exception to a trustee's abandonment powers to be narrowly applied. The Court provided the following admonition to lower courts applying the *Midlantic* exception:

This exception to the abandonment power vested in the trustee by § 554 is a narrow one. It does not encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm.³⁶

Despite this admonition to apply the *Midlantic* exception narrowly, this judicially crafted public policy rule has served as the basis for another judicially crafted deviation from the Bankruptcy Code—the *per se* treatment of P&A liabilities as post-petition administrative priority expenses.³⁷ While the treatment of P&A liabilities as post-petition administrative expenses is appropriate under *Midlantic* in certain very limited circumstances, a *per se* rule granting administrative expense priority or prohibiting the abandonment of oil and gas producing properties by a trustee or debtor-in-possession constitutes a misapplication of the *Midlantic* exception.

B. A “Necessary” Examination of Key Fifth Circuit Cases

The question becomes: how did the narrow *Midlantic* exception become the lynchpin in a broad priority-shifting rule depriving offshore oil and gas debtors of the ability to control their own destiny in a chapter 11 case? As we will examine, that particular odyssey begins with the determination that certain claims for reimbursement of expenses related to plugging and abandonment activities performed on behalf of a debtor

34. *Id.* at 507.

35. *Id.*

36. *Id.* at n.9. Further, in his dissent, Justice Rehnquist quipped that the limitation was a nice surprise that somewhat limited his disagreement with the majority. *Id.* at 507 (Rehnquist, W., dissenting).

37. *See, e.g., In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 812, 816-17 (Bankr. S.D. Tex. 2009); *In re ATP Oil & Gas Corp.*, 2014 WL 1047818, at *7-8 (Bankr. S.D. Tex. Mar. 18, 2014).

were entitled to priority payment ahead of other creditors under § 503 of the Bankruptcy Code. From this relatively benign determination, bankruptcy courts and practitioners have wrongfully divined a rule that grants immense determinative powers over a debtor to government agencies charged with enforcing statutory P&A obligations and, potentially, any other party that may be jointly liable for such obligations.

1. What Is an Administrative Expense, and Why Does It Matter?

Section 503 of the Bankruptcy Code provides that “the actual, necessary costs and expenses of preserving the estate” are to be characterized as administrative expenses, and § 507 provides that these administrative expenses are entitled to priority payment.³⁸ Under § 1129, a chapter 11 plan may only be confirmed if the plan provides for the payment in full of administrative expense claims on the date the plan becomes effective, except to the extent that a claimant agrees to accept different treatment.³⁹ As such, creditors holding large administrative expense claims often have the *de facto* power to block a debtor’s proposed plan of reorganization. This *de facto* veto is especially powerful in E&P cases where a debtor is in some capacity liable for post-petition P&A work that can often cost tens, if not hundreds, of millions of dollars.

Given this tremendous leverage afforded to the holder of such a large administrative expense claim, the decision to afford P&A claims administrative priority is substantial. Typically, to be entitled to an administrative priority claim, a claimant must show that its claim arises from (1) a necessary cost or expense; (2) that has actually been incurred; (3) by or on behalf of the debtor.⁴⁰ In early cases examining the treatment of P&A expenses under the Bankruptcy Code, courts allowed administrative expense priority for amounts *actually* expended by non-debtors to perform P&A activities on behalf of a debtor.⁴¹ However, the progeny of case law discussed herein has led to the common practice whereby potential P&A claimants, and in particular the United States government, file claims in a debtor’s bankruptcy case and then seek allowance of such claims as administrative expenses—regardless of whether such claims are contingent in nature or have not yet been

38. 11 U.S.C. §§ 503, 507 (2012).

39. *Id.* § 1129(a)(9).

40. *Id.*

41. *See, e.g., Texas v. Lowe (In re H.L.S. Energy Co.)*, 151 F.3d 434 (5th Cir. 1998); *In re Am. Coastal Energy, Inc.*, 399 B.R. 805.

liquidated.⁴² Given the size of these potential claims, the mere possibility that such claims could be treated as administrative expenses—even though, under the elements set forth above, contingent and unliquidated claims should not be considered “actual” or “necessary” costs or expenses—can threaten a debtor’s ability to fashion a plan for the benefit of all creditors.

Moreover, given the development of case law in the Fifth Circuit, such preferential treatment is not a mere possibility but is perhaps a certainty. Indeed, post-*Midlantic*, the Fifth Circuit has found that state or federal law requires a debtor to complete P&A work related to oil and gas properties during the pendency of a bankruptcy case and has implicitly adopted a rule prohibiting abandonment of properties burdened by outstanding P&A liabilities.⁴³ Under such a determination, the costs to satisfy such obligations (including those that remain contingent or unliquidated) are entitled to administrative priority treatment under the Bankruptcy Code. Two cases form the foundation for this outcome. In *Texas v. Lowe (In re H.L.S. Energy Co.)*, the Fifth Circuit Court of Appeals held that the costs incurred by a state regulatory agency to satisfy a debtor’s P&A obligations arising post-petition were actual and necessary costs of managing a debtor’s estate and were entitled to administrative priority.⁴⁴ In *In re American Coastal Energy, Inc.*, the Bankruptcy Court for the Southern District of Texas took *H.L.S. Energy* a step further and held that post-petition expenditures satisfying pre-petition P&A obligations are also entitled to administrative priority status.⁴⁵ These decisions developed the concept—completely without support from the Bankruptcy Code—that all P&A obligations that are not satisfied by a debtor’s petition filing date, whether contingent or unliquidated and whether the debtor is the primary obligor or not, are to be treated as administrative expense claims and must be paid in full before the debtor can emerge from bankruptcy.

42. See, e.g., Proof of Claim No. 102, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2017); Proof of Claim No. 56, *In re Bennu Oil & Gas, LLC*, No. 16-35930 (Bankr. S.D. Tex. 2017); Proof of Claim No. 45, *In re Bennu Oil & Gas, LLC*, No. 16-35930 (Bankr. S.D. Tex. 2017).

43. *In re H.L.S. Energy Co.*, 151 F.3d at 438.

44. *Id.* at 439.

45. *In re Am. Coastal Energy, Inc.*, 399 B.R. at 816-17.

2. *H.L.S. Energy* and the Battle of Post-Petition P&A

In *H.L.S. Energy*, the issue before the Fifth Circuit was “the [determination of the] priority to be afforded a state’s claim on the bankruptcy estate, for costs incurred by the state in satisfaction of the estate’s post-petition environmental obligations.”⁴⁶ The facts and procedural history of the case are significant.

When H.L.S. Energy Co., Inc. filed its petition for reorganization under chapter 11 of the Bankruptcy Code, it entered into bankruptcy holding a number of inactive wells for which P&A work had not commenced.⁴⁷ After selling off its viable assets, the debtor’s case was converted to a chapter 7 liquidation.⁴⁸ Prior to the conversion, the State of Texas brought an enforcement action seeking to require H.L.S. Energy to commence P&A activities pursuant to title 16, section 3.9 of the Texas Administrative Code, which requires that P&A operations on each dry or inactive well be commenced within a period of one year after drilling or operations cease.⁴⁹ Importantly, while the wells at issue ceased production at various times before and after the petition date, none had been inactive for more than a year prior to the filing of the bankruptcy case.⁵⁰ After negotiations with the chapter 11 trustee, the State agreed to plug the wells and charge the cost against the bankruptcy estate.⁵¹ The State expended \$41,808, for which it asserted an administrative expense claim.⁵² After the case converted to chapter 7 liquidation, the chapter 7 trustee challenged the priority of the State’s claim, arguing that P&A work provided no benefit to the debtor’s estate.⁵³ The bankruptcy court found, and the district court agreed, that the State’s claim should be entitled to priority treatment as an administrative expense.⁵⁴

Applying the broad interpretation of actual, necessary costs espoused by the United States Supreme Court in *Reading Co. v. Brown*, the Fifth Circuit affirmed the lower court’s holding, which afforded priority status to the State’s claim.⁵⁵ The court’s determination that the debtor was under an existing requirement to complete P&A work and

46. *In re H.L.S. Energy Co.*, 151 F.3d at 436 (emphasis added).

47. *Id.*

48. *Id.*

49. *Id.*; 16 TEX. ADMIN. CODE § 3.9 (2017).

50. *In re H.L.S. Energy Co.*, 151 F.3d at 436.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* at 439; *see Reading Co. v. Brown*, 391 U.S. 471, 485 (1968).

that its continuing failure to do so was actively resulting in a reduction of available assets was critical to the holding.⁵⁶ The court reasoned:

Under federal law, bankruptcy trustees must comply with state law. Furthermore, a bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety. 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. Furthermore, because the wells became inactive post-petition or after a year prior to the petition, the plugging obligations on these wells accrued post-petition. Thus, a combination of Texas and federal law placed on the trustee an inescapable obligation to plug the unproductive wells, an obligation that arose during the chapter 11 proceedings.

The fulfillment of this, the estate's obligation, can only be seen as a benefit to the estate. In this sense, the state's action resembles the sort of "salvage" work that lies at the heart of the administrative expense priority. No one would challenge the expense of shoring up the sagging roof on a bankrupt's warehouse, for example, where carpentry was needed to prevent further damage to the structure or liability from injury to passers-by. The laws of Texas compelled action in this case just as surely as would the laws of physics in that one. The unplugged unproductive wells operated as a legal liability on the estate, a liability capable of generating losses in the nature of substantial fines every day the wells remained unplugged.⁵⁷

As such, the *H.L.S. Energy* court held, "because we conclude that the cost of plugging the wells in accordance with Texas law was an 'actual and necessary cost' of managing the estate, we agree that such cost must be afforded priority as an administrative expense."⁵⁸

3. *American Coastal* Commandeers Pre-Petition P&A

Curiously, *H.L.S. Energy* left open the question of whether the cost of performing P&A work for liabilities arising pre-petition is likewise entitled to administrative priority status. This question was addressed by the Bankruptcy Court for the Southern District of Texas in *American Coastal*, wherein the Bankruptcy Court expanded upon the *H.L.S. Energy* holding and found that costs incurred post-petition to satisfy outstanding P&A obligations are entitled to administrative priority even if such P&A obligations arose pre-petition.⁵⁹ Like the debtor in *H.L.S. Energy*, the debtor in *American Coastal* entered bankruptcy holding a

56. *In re H.L.S. Energy Co.*, 151 F.3d at 438.

57. *Id.* (citations omitted).

58. *Id.* at 439.

59. *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 816 (Bankr. S.D. Tex. 2009).

number of inactive wells.⁶⁰ Unlike *H.L.S. Energy*, however, the wells at issue in *American Coastal* had been idle for more than a year prior to the petition date.⁶¹ Immediately following the petition date, the Texas Railroad Commission expended \$496,952.35 to decommission the debtor's wells.⁶² Of that amount, the debtor paid \$75,000.00 under a settlement and listed the remaining \$421,952.35 as a general unsecured claim in the plan—i.e., not an administrative expense.⁶³ The State objected, arguing that it was entitled to payment as an administrative expense claimant.⁶⁴

Like the Fifth Circuit in *H.L.S. Energy*, the Bankruptcy Court in *American Coastal* resolved the priority dispute by focusing upon the determination that the debtor was under an enforceable obligation to complete the P&A work.⁶⁵ The court stated:

Under § 959 and *Midlantic*, the debtor's obligation to plug the wells in accordance with Texas law is a continuing post-petition obligation. [Accordingly, the debtor's] continuing post-petition duty to conform with Texas law renders expenditures necessary to conform with that law actual and necessary costs of preserving the estate entitled to § 503(b)(1)(A) administrative priority.⁶⁶

Thus, the court held that the “the Commission's expense clearly benefited [the debtor's estate] by expending funds that fulfilled [the debtor's] continuing plugging obligations and precluded the accrual of monetary fines.”⁶⁷

C. A Course Correction?

The impact of *H.L.S. Energy* and *American Coastal* has been significant. The broad application of the *Midlantic* exception in these cases essentially granted a relatively small number of creditors in E&P bankruptcy cases an inordinate amount of leverage over plan construction and confirmation. While the Fifth Circuit cited *Midlantic* as support for its holding in *H.L.S. Energy*, the court misapplied the *Midlantic* exception. Indeed, the Fifth Circuit significantly overstated the

60. *Id.* at 807.

61. *Id.*

62. *Id.*

63. *Id.* at 808.

64. *Id.*

65. *Id.* at 811.

66. *Id.* at 811-12.

67. *Id.* at 816.

Midlantic exception, stating that abandonment is prohibited if such abandonment would contravene any state law reasonably designed to protect public health or safety generally—not from an imminent and identifiable harm.⁶⁸ Further, in reaching its conclusion in *H.L.S. Energy*, the Fifth Circuit failed to consider whether its application of Texas law imposed conditions on abandonment that are so onerous that they interfere with the bankruptcy adjudication itself.

At least one court in the Fifth Circuit appears to have noticed this significant omission in the application of *Midlantic* espoused by the *H.L.S. Energy* and *American Coastal* courts. In *In re Howard*, the Bankruptcy Court for the Southern District of Mississippi examined a trustee's abandonment power *vis-a-vis* *Midlantic* and noted that the majority of courts to consider the issue have relied upon footnote nine to limit *Midlantic*'s restrictions.⁶⁹ In *In re Howard*, the Bankruptcy Court cited to several cases from other circuits that emphasized the limited nature of the *Midlantic* exception:⁷⁰

The majority of Courts that have interpreted footnote nine (9) in *Midlantic* have held that the “narrow” exception to a trustee's abandonment power only applies in situations where an imminent and identified harm to the public health and safety exists. *See N.M. Env't Dep't v. Foulston (In re L.F. Jennings)*, 4 F.3d 887, 890 (10th Cir. 1993) (“[B]efore abandonment of a property can violate *Midlantic* the property must represent an immediate and identifiable harm to public health or safety.”) (citations omitted); *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12, 16 (4th Cir. 1988) (“[T]his narrow exception applies where there is a serious health risk, not where the hazards are speculative or may await appropriate action by an environmental agency.”); *Minn. Pollution Control Agency v. Gouveia (In re Globe Building Materials)*, 345 B.R. 619, 629 (Bankr. N.D. Ind. 2006) (“This Court also deems the *Midlantic* decision to stand solely for the proposition that a chapter 7 trustee may not abandon property from a bankruptcy estate under 11 U.S.C. § 554(a) without taking actions necessary to abate conditions which pose an ‘imminent and identifiable harm’ to ‘the public health or safety.’”); *In re Guterl Special Steel Corp.*, 316 B.R. 843, 858-59 (Bankr. W.D. Pa. 2004) (“If there is no imminent threat to public health or safety, abandonment pursuant to § 554(a) may be permitted even though state laws or

68. *In re H.L.S. Energy Co.*, 151 F.3d 434, 438 (5th Cir. 1998).

69. *In re Howard*, 533 B.R. 532, 545-46 (Bankr. S.D. Miss. 2015).

70. *Id.*

regulations designed to protect public health or safety will be violated as a consequence.”⁷¹

The sheer length of this comprehensive citation makes a powerful point regarding the significance of *Midlantic*'s footnote nine and how the Supreme Court intended it to be interpreted by the district courts. *Howard* also indirectly calls into question *H.L.S. Energy* and its progeny such as *American Coastal*, which assume, without application of footnote nine's limiting element, that E&P debtors may not abandon properties subject to burdensome P&A liabilities.

The resultant fallout of this misapplication of *Midlantic* has been far reaching. *H.L.S. Energy* has been read to require a near *per se* rule prohibiting the abandonment of properties with outstanding P&A liabilities.⁷² Further, as a corollary to this prohibition against abandonment, bankruptcy courts have further found that P&A obligations—whether matured and owing, contingent, or unliquidated—may be entitled to payment as administrative expenses in almost any circumstance. In essence, what was initially crafted as a narrow exception to the Bankruptcy Code's abandonment provisions has become a nearly insurmountable hurdle to confirmation of chapter 11 plans in offshore E&P cases.

Yet, while *Howard* makes clear that the foundation of *H.L.S. Energy*—i.e., the unexamined assumption that the trustee was prohibited from abandoning the subject properties—misinterprets the *Midlantic* exception, *Howard* does not address the appropriate priority to be granted P&A claims. Part III of this Article examines this question primarily in the offshore E&P context.

III. SETTING ANCHOR: UNDERSTANDING P&A LIABILITY AND TIMING

Generally speaking, the goal of bankruptcy law is to provide debtors a means of financial rehabilitation. For offshore E&P debtors with end-of-life oil and gas properties, the swell of claims resulting from statutory P&A liability has placed a significant obstacle in the pursuit of plan confirmation. As discussed in Part II *supra*, in the Fifth Circuit this significant hurdle results from an apparent *per se* rule that end-of-life

71. *Id.*

72. *In re H.L.S. Energy Co.*, 151 F.3d 434; *In re Am. Coastal Energy, Inc.*, 399 B.R. 805. *But see In re ATP Oil & Gas Corp.*, No. 12-36187, 2013 Bankr. LEXIS 2608, at *9 (Bankr. S.D. Tex. June 19, 2013) (wherein the Bankruptcy Court for the Southern District of Texas acknowledged that, when a debtor lacks sufficient funds to meet its P&A obligations, abandonment may actually further the environmental regulatory scheme).

E&P properties may not be abandoned and the corollary judicial development that grants claims arising from statutory P&A regulations treatment as administrative expense claims. The enormity of this burden is easily illustrated. In a recent case in the Southern District of Texas, *In re Black Elk Energy Offshore Operations, LLC*, the debtor owned and operated numerous platforms in the Gulf of Mexico.⁷³ During the bankruptcy, the government filed a proof of claim in excess of \$660 million.⁷⁴ The government later filed an administrative expense request seeking the allowance of more than \$714 million for the debtor's decommissioning obligations.⁷⁵ It is easy to see how the determination of allowance and priority for such a claim has a dramatic impact upon the debtor's ability to formulate a feasible plan and upon any resulting distributions to creditors.⁷⁶ As oil prices do not appear to be poised for any imminent rebound, offshore E&P bankruptcy cases will likely continue in the near term. Determining a workable solution for the allowance and treatment of P&A claims is a must.

As discussed *supra*, the *H.L.S. Energy* and *American Coastal* courts both determined that the respective debtors defaulted under their existing obligations to perform statutorily required P&A work. These findings were key to the ultimate determination of priority. In other words, much like the trustee in *Midlantic*, abandonment of the *H.L.S. Energy* or *American Coastal* properties would have operated to relieve the debtor's estate from a statutory obligation designed to protect the health and safety of the public. Under *Midlantic*, however, this public health and safety policy goal, no matter how warranted, is not sufficient. Instead, *Midlantic* requires that § 554 be limited only in situations where there is (1) an imminent and identifiable harm to the public health or safety; and (2) the underlying regulation does not pose a requirement so onerous as to interfere with the bankruptcy adjudication itself. As noted in *Howard*, *Midlantic* should not be read to *per se* prohibit the abandonment of P&A

73. Second Am. Disclosure Statement, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016), ECF No. 828.

74. Proof of Claim No. 102, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016).

75. U.S. Am. Mot. for Allowance of Admin. Exp. Pursuant to 11 U.S.C. § 503(b), *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016), ECF No. 894 (Ultimately the Department of Interior (DOI) accepted a negotiated settlement that provided for the performance of a significant portion of the debtor's P&A obligations on its operated properties).

76. In fact, resolution of the DOI claim became one of the primary focal points in negotiating the Black Elk plan.

burdened properties. If abandonment is not *per se* prohibited, should P&A liabilities ever be afforded administrative expense priority?

The answer, of course, is not simple. Indeed, while neither *H.L.S. Energy* nor *American Coastal* actually examined the abandonment question, it is not difficult to envision circumstances—such as the presence of an uncontrolled flow at a well or a well with a significantly damaged platform—that would justify restricting abandonment under § 554. Further, abandonment may not always be the best answer. In order to determine a just and equitable treatment of P&A obligations and liabilities, it is important to first examine the nature and scope of these claims.

A. *Defining the Debtor's Decommissioning Obligations*

A debtor's "plugging and abandonment" or "decommissioning" obligations generally refer to state or federal statutory liabilities that arise at the end of an oil and gas well's useful life.⁷⁷ These obligations include "plugging" of the well, removal of platforms and other facilities, and site clearance.⁷⁸ The scope and performance of such activities are governed by acts of Congress (or state legislatures) and a host of regulatory agencies whose purpose is to oversee and intervene where appropriate.⁷⁹

These laws and regulations are administered both at the state and federal levels of government. At the federal level, this includes the Bureau of Ocean Energy Management (BOEM) and the Bureau of Safety and Environmental Enforcement (BSEE). Most states also have their own regulatory agency charged with enforcing similar laws and regulations. For example, in Texas, as seen in the cases discussed above,

77. Mark A. Chavez, Philip G. Eisenberg, & Omer F. Kuebel III, *Decommissioning/Plugging and Abandonment Liabilities in Bankruptcy: What Priority Should They Be Afforded?* 57 ANN. INST. OIL & GAS L. 11-1, 11-2 n.1 (2006).

78. *Id.*

79. Initially, it is important to note that the risk of harm to the environment accompanying offshore E&P activities necessarily mandates a prudent level of regulation. Consider the BP oil spill in 2010, which caused upwards of \$60 billion in damage to the environment and resulted in a \$20 billion settlement with the government. Steven Mufson, *BP's Big Bill for the World's Largest Oil Spill Reaches \$61.6 Billion*, WASH. POST (July 14, 2016), https://www.washingtonpost.com/business/economy/bps-big-bill-for-the-worlds-largest-oil-spill-now-reaches-616-billion/2016/07/14/7248cdaa-49f0-11e6-acbc-4d4870a079da_story.html?utm_term=.90aa646a5604; Tim Stelloh, *Judge Approves \$20 Billion Settlement in BP Oil Spill*, NBC NEWS (Apr. 4, 2016), <https://www.nbcnews.com/business/business-news/judge-approves-20-billion-settlement-bp-oil-spill-n550456>. Thus, the risks associated with these ventures cannot be taken lightly; for that reason, the industry is subject to stringent laws and regulations.

the Texas Railroad Commission is charged with regulating oil and gas production.

The multitude of regulatory agencies have generated various regulatory requirements and environmental obligations, including decommissioning obligations. At the federal level, these regulations are set forth in the Code of Federal Regulations (C.F.R.).⁸⁰ Collectively, these regulations establish the duties and obligations imposed upon E&P companies operating offshore on federal leases, including decommissioning obligations. Chapter 30, § 250.1700 of the C.F.R. defines “decommissioning” as (1) ending oil, gas, or sulphur operations; and (2) returning the lease or pipeline right-of-way to a condition that meets the regulations and requirements of BSEE and other agencies with jurisdiction over the decommissioning activities.⁸¹ Pursuant to these regulations, when a debtor’s facilities are no longer useful for operations, the debtor must take the following actions:

- (1) Get approval from the appropriate District Manager before decommissioning wells and from the Regional Supervisor before decommissioning platforms and pipelines or other facilities;
- (2) Permanently plug all wells . . . ;
- (3) Remove all platforms and other facilities, except as provided in §§ 250.1725(a) and 250.1730;
- (4) Decommission all pipelines;
- (5) Clear the seafloor of all obstructions created by [the] lease and pipeline right-of-way operations . . . ; and
- (6) Conduct all decommissioning activities in a manner that is safe and does not unreasonably interfere with other uses of the OCS, and does not cause undue or serious harm or damage to the human, marine, or coastal environment.⁸²

Guidance regarding the timing of permanent P&A work is provided in §§ 250.1710 and 250.1711, which require that such work be accomplished within one year of the termination of a lease (§ 250.1710) or upon a BSEE order if such well is no longer useful or poses an imminent environmental risk (§ 250.1711).⁸³ Although, on the one hand, BOEM/BSEE typically assert that P&A liability arises the moment the environment is invaded for E&P operations,⁸⁴ the regulations make clear

80. See 30 C.F.R. §§ 250.1700-.1754 (2017); 28 U.S.C. § 959(b) (2012).

81. 30 C.F.R. § 250.1700.

82. 30 C.F.R. § 250.1703.

83. 30 C.F.R. §§ 250.1710-.1711.

84. 30 C.F.R. § 250.1702.

that such liability ripens only upon the determination that properties are either no longer useful or pose an imminent environmental risk.

Applying these timing mandates, it is possible to divide a debtor's P&A obligations into two distinct categories. First, there are matured obligations for properties that are "no longer useful for operations." For purposes of this Article, we refer to these properties as "Non-Producing Properties." Second, there are unmatured and unliquidated obligations for properties that remain useful for operations. We refer to these properties as "Producing Properties."

Additionally, while a debtor may be the primary obligee as to decommissioning work on properties where the debtor is the operator of record (Operated Properties), such is not the case for properties in which a debtor merely holds a joint interest or is a predecessor in title (Non-Operated Properties). As to these Non-Operated Properties, the debtor may be subject to joint and several liability and, in the event of a default by the operator or other party with primary liability, could be ordered to satisfy P&A obligations, but is not the primary obligee. As such, regardless of whether the associated P&A liabilities arise from a Non-Producing Property or a Producing Property, the statutory liability of the debtor for Non-Operated Properties is contingent in nature.

With these categories in mind, we must now turn back to § 503 of the Bankruptcy Code to determine a just treatment. Section 503 provides that "the actual, necessary costs and expenses of preserving the estate" are to be characterized as administrative expenses and are entitled to priority under § 507.⁸⁵ Thus, a claim under § 503 must meet two elements: actual and necessary. We will analyze these in reverse order.

B. Is Compliance with P&A Obligations "Necessary"?

1. Necessary?—Yes. Necessary to the Administration of a Bankruptcy Case?—Probably Not.

As discussed above, the *H.L.S. Energy* court ultimately decided that expenses advanced to satisfy the debtor's outstanding and owing P&A liabilities were "necessary" because the debtor was being fined daily due to a lack of compliance and the debtor was unable to abandon the property.⁸⁶ We have examined the fault in the court's conclusion regarding abandonment and now turn to examining the underlying question of whether P&A liabilities are "necessary" under the *Reading*

85. 11 U.S.C. §§ 503, 507 (2012).

86. *In re H.L.S. Energy Co.*, 151 F.3d 434, 438 (5th Cir. 1998).

definition. *H.L.S. Energy* provides a succinct analysis of “necessary” under the Bankruptcy Code.⁸⁷ As set forth therein:

An “actual and necessary cost” must have been of benefit to the estate and its creditors. This requirement is in keeping with the conceptual justification for administrative expense priority: that creditors must pay for those expenses necessary to produce the distribution to which they are entitled. “That is, the costs of salvage are to be paid.” The “benefit” requirement has no independent basis in the Code, however, but is merely a way of testing whether a particular expense was truly “necessary” to the estate: If it was of no “benefit,” it cannot have been “necessary.”⁸⁸

As to the P&A claims at issue before the court, the Fifth Circuit placed significant weight upon the increasing amount of the debtor’s liability deriving from daily fines.⁸⁹ The court explained:

The fulfillment of this, the estate’s obligation, can only be seen as a benefit to the estate. In this sense, the state’s action resembles the sort of “salvage” work that lies at the heart of the administrative expense priority. No one would challenge the expense of shoring up the sagging roof on a bankrupt’s warehouse, for example, where carpentry was needed to prevent further damage to the structure or liability from injury to passers-by. The laws of Texas compelled action in this case just as surely as would the laws of physics in that one. The unplugged unproductive wells operated as a legal liability on the estate, a liability capable of generating losses in the nature of substantial fines every day the wells remained unplugged.⁹⁰

Although the *H.L.S. Energy* court appears to have accorded great weight in the incurrence of daily fines, it is not difficult to conclude that P&A expenses, even without daily regulatory fines, are similar in nature to the sagging roof cited by the court.⁹¹ Offshore E&P facilities pose some inherent risk to the public health and safety. Yet, the costs to decommission these facilities are extremely high, and given the timing of when such decommissioning expenses become due (i.e., the end of an E&P property’s useful life) these costs easily render properties with outstanding P&A liabilities a burden to a debtor’s estate. Accordingly, unless some rule prohibits such properties from being abandoned, then abandonment under § 554 is the most appropriate course.⁹²

87. *Id.* at 437 (citations omitted).

88. *Id.* (citations omitted).

89. *Id.* at 438.

90. *Id.* (citation omitted).

91. *Id.*

92. *See* 11 U.S.C. § 554 (2010).

2. Does *Midlantic* Prohibit Abandonment?

Reading further into *Midlantic*, one can see that the case does not prohibit abandonment of property unless, as set forth in footnote 9, certain conditions are met.⁹³ Indeed, a thorough reading of the case demonstrates that a trustee's abandonment power should remain unfettered, unless abandonment of the property would pose an "imminent and identifiable" harm to public health or safety.⁹⁴ This begs the question: who has the burden of demonstrating the existence of an imminent and identifiable harm? Surely the onus is not on the trustee of an offshore E&P debtor to prove that *none* of the wells and platforms are at risk. As mentioned by the Court in *Midlantic*, perhaps the government, or a similarly situated objecting party, is in the best position to set forth which specific properties pose threats.⁹⁵

What is clear, however, is that the presumption that all end-of-life E&P properties pose an imminent threat to the public health and safety is meritless. Indeed, C.F.R. § 250.1711, which contemplates a BSEE-issued order to commence decommissioning work upon a determination that a well poses an imminent environmental threat, inherently supports the opposite conclusion.⁹⁶ If all end-of-life facilities posed an imminent threat, why would there be a need for BSEE to make such a finding prior to the conclusion of the one-year grace period? Of course, § 250.1711 also implicates circumstances that may exist, such as uncontrolled flow or deteriorated platforms, which require immediate P&A activities.⁹⁷ Put another way, the applicable Code of Federal Regulations sections already contemplate *Midlantic*'s "imminent and identifiable" standard, and permitting abandonment except when such circumstances exists is not entirely contrary to the existing regulatory scheme.⁹⁸ Further, programs such as the temporary abandonment and the Rigs to Reefs programs (discussed below) illustrate a regulatory acknowledgement that abandonment—whether temporary or permanent—may be accomplished in such a manner as to minimize any identifiable threat to the public health and safety.⁹⁹

93. *Midlantic Nat'l Bank v. N.J. Dep't of Env'tl. Prot.*, 474 U.S. 494, 507 n.9 (1986).

94. *Id.* at 506.

95. *Id.* at 498.

96. 30 C.F.R. § 250.1711 (2017).

97. *Id.*

98. *Midlantic*, 474 U.S. at 506; *id.* at 515 (Rehnquist, W., dissenting).

99. John McKinney, *After the Oil Runs Out: Rigs to Reefs*, PAC. STANDARD (July 15, 2010), <https://psmag.com/environment/after-the-oil-runs-out-rigs-to-reefs-19272>.

Finally, bankruptcy courts examining abandonment of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) Superfund¹⁰⁰ properties or other properties with contained environmental contamination have found that abandonment is appropriate under *Midlantic* unless immediate remediation of an identified health and safety threat is required. For example, in *In re Purco, Inc.*, the court found that a “necessary corollary to [*Midlantic*’s holding] is that abandonment will be permitted when the conditions are such that abandonment will not render the public health and safety inadequately protected.”¹⁰¹ Likewise, in *In re Franklin Signal Corp.*, the court held that a trustee need only take adequate precautionary measures to ensure that there is no imminent danger to the public as a result of the abandonment.¹⁰² In that case, the court did not believe a strict reading of *Midlantic* would produce the result the Supreme Court would have intended.¹⁰³ Rather, the court found the “total disregard for potential hazards is the concern the majority seemed be addressing” and cited the *Midlantic* trustee’s failure to take any action whatsoever to safeguard the public.¹⁰⁴

C. Are Estimated P&A Costs “Actual” Expenses?

Even if P&A costs and expenses are deemed necessary, in order to be granted administrative priority, the costs and expenses must actually be incurred.¹⁰⁵ In *In re Rock & Republic Enterprises*, the court explained “[a]lthough a claim may be contingent, only ‘actual’ administrative expenses, not contingent expenses, are entitled to priority under § 503.”¹⁰⁶ The *Rock & Republic* court found the reasoning of courts allowing contingent environmental claims administrative priority on the grounds that the definition of “claim” includes contingent rights to payment

100. CERCLA, or Superfund, is a federally administered program through which the Environmental Protection Agency (EPA) works with state and tribal governments to perform remediation services and clean up hazardous waste sites. The statute also allows the EPA to force responsible parties to perform cleanup services directly or reimburse the government for cleanups performed by the EPA. ENVTL. PROT. AGENCY, OFFICE OF SOLID WASTE & EMERGENCY RESPONSE, THIS IS SUPERFUND: A COMMUNITY GUIDE TO EPA’S SUPERFUND PROGRAM 3 (2011), <https://semspub.epa.gov/work/HQ/175197.pdf>.

101. *In re Purco Inc.*, 76 B.R. 523, 533 (Bankr. W.D. Pa. 1987).

102. *In re Franklin Signal Corp.*, 65 B.R. 268, 272 (Bankr. D. Minn. 1986).

103. *Id.* at 271.

104. *Id.*

105. 11 U.S.C. § 503(b)(1)(a) (2012).

106. *In re Rock & Republic Enters.*, No. 10-11728 (AJG), 2011 Bankr. LEXIS 3903, at *13 (Bankr. S.D.N.Y. Oct. 7, 2011).

unpersuasive.¹⁰⁷ The court expressly held that the definition of “claim” is irrelevant to the determination of priority pursuant to § 503(b)(1)(a).¹⁰⁸ Other courts considering the issue have also determined that contingent environmental remediation costs are not entitled to administrative priority.¹⁰⁹

D. Too Great A Weight?

Finally, given the growing size of P&A claims, it is conceivable that in the near future bankruptcy courts will be required to consider the question left open by the Supreme Court in *Midlantic*: whether decommissioning requirements placed an unfair burden on the debtor’s estate.¹¹⁰ This issue was left open by the Court in *Midlantic* wherein the Court issued its holding “without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself.”¹¹¹ Thus, even when Non-Producing Properties are deemed to pose an imminent and identifiable threat to public health and safety, resolving such issues in compliance with federal or state law may simply be impossible.¹¹²

Indeed, the *American Coastal* court acknowledged “the possibility that environmental liabilities may be so significant in relation to the debtor’s ability to pay that characterizing all or a portion of an environmental claim as an administrative expense may unduly ‘interfere with the bankruptcy adjudication itself.’”¹¹³ However, in that case the debtor did not allege the government’s claim was unduly onerous and

107. *Id.*

108. *Id.*

109. *See* *Juniper Dev. Grp. v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915, 930 (1st Cir. 1992) (finding claims for future response costs to be unavailing insofar as the right to contribution for such costs remained contingent at the time the court considered the claim); *see also In re Oldco M. Corp.*, 438 B.R. 775, 786 (Bankr. S.D.N.Y. 2010) (disallowing request for administrative expense related to future environmental remediation costs that debtor may or may not have to pay in the future as too speculative to support the allowance of an administrative expense); *In re Microfab, Inc.*, 105 B.R. 161, 166 (Bankr. D. Mass. 1989) (denying as premature the state’s request for allowance of an administrative expense as the state had not yet expended any funds to clean up the site and it “cannot speculate as to what amounts might eventually be allowable as ‘actual’ and ‘necessary’ expenses of the estate”).

110. *Midlantic Nat’l Bank v. N.J. Dep’t of Env’tl. Prot.*, 474 U.S. 494, 516 (1986) (Rehnquist, W., dissenting).

111. *Id.* at 507 (majority opinion).

112. *See id.* at 508 (explaining the purpose of bankruptcy liquidation is the expeditious reduction of the debtor’s property to money, for equitable distribution to creditors) (Rehnquist, W., dissenting).

113. *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 814 (Bankr. S.D. Tex. 2009).

instead provided that, via its plan, 100% of the government's claim would be paid on the effective date.¹¹⁴

Ultimately, what becomes most apparent is that the misapplication of the *Midlantic* exception espoused by Fifth Circuit courts in E&P bankruptcy cases is not workable. Section 554 is a significant power that should not be fettered in the absence of a significant public interest. As shown above, while, generally speaking, the enforcement of environmental regulations is a necessary regulatory exercise, a *per se* rule that prohibits abandonment of E&P properties subject to outstanding P&A obligations is supported by neither the Bankruptcy Code nor the Supreme Court's exception thereto set forth in *Midlantic*. As abandonment may indeed be permissible when *Midlantic* is properly applied, the seeming conclusion that all P&A liabilities remaining unsatisfied as of a debtor's bankruptcy filing are entitled to administrative priority treatment often read into *H.L.S. Energy* fails. If abandonment is possible, performing P&A work on a Non-Producing Property may provide little or no benefit to an estate. However, when a Non-Producing Property can be shown to represent an imminent and identifiable threat to the public health, at least some P&A work—either temporary or permanent—must be performed in order to comply with *Midlantic*. In such circumstances, as espoused by the *H.L.S. Energy* court, the cost to perform such P&A work should be granted administrative priority.

Further, granting administrative priority to regulatory bodies may often be inappropriate because in many instances the responsible regulatory authority will not perform P&A work itself, and in fact may never expend any funds related to the performance of P&A work. In such cases, unlike the claims of the Texas Railroad Commission in *H.L.S. Energy* and *American Coastal*, the enforcing agency's claim should not be considered an actual and necessary expense of the estate. Thus, even for those Non-Producing Properties for which P&A work is necessary, a claimant should be required to show that it has actually expended funds to bring the debtor into legal compliance to be entitled to an administrative expense claim. Extending the same reasoning, claims related to future P&A work involving Producing Properties and contingent claims for a debtor's share of P&A costs involving Non-Operated Properties should never be granted administrative priority status.

114. *Id.*

IV. PRACTICAL SOLUTIONS TO THE P&A PROBLEM

The minority of the *Midlantic* Court approached the case in a more logical manner. Indeed, in a rather pointed dissent, Justice Rehnquist reminds readers that the very purpose of the judge-made abandonment rule was to further the purpose of the bankruptcy liquidation process; that is, the expeditious reduction of the debtor's property to money for equitable distribution to creditors.¹¹⁵ Further, the plain language of § 554 expresses a rule in which the only material consideration to be made is the value of the property to the debtor's estate.¹¹⁶ Although precedent would dictate the Court should not read exceptions or limitations into such unqualified statutory language, the *Midlantic* Court engaged in a judicial triage of sorts to reach the ultimate conclusion that a trustee's abandonment power, although seemingly unlimited on its face, must actually yield to other considerations not enumerated in the Bankruptcy Code.¹¹⁷

The *Midlantic* exception is seemingly the only judicially established limitation placed upon the abandonment powers set forth in § 554. Notably, subsequent case law acknowledges that the Bankruptcy Code itself does not explicitly limit the abandonment powers of § 554.¹¹⁸ Likewise, nothing in the code expressly provides for administrative priority to contingent, unliquidated P&A liabilities. While a trustee certainly should not "have *carte blanche* to ignore nonbankruptcy law,"¹¹⁹ she should also not be hamstrung by such nonbankruptcy law in effectuating her duties as trustee. Yet, the concerns underlying decisions such as *Midlantic*, *H.L.S. Energy*, and *American Coastal* are significant, legitimate concerns. If § 554 abandonment is not forced to yield to such concerns, and abandonment of E&P properties is unfettered, what mechanisms exist to curtail the potential for abuse? The following existing policies or statutory requirements may be of aid.

115. *Midlantic*, 474 U.S. at 508 (Rehnquist, W., dissenting).

116. *Id.* at 509.

117. *Id.* at 510.

118. See, e.g. *In re Am. Coastal Energy, Inc.*, 399 B.R. at 811 ("*Midlantic* was not decided based on the statutory language of the Bankruptcy Code."); see also *Midlantic*, 474 U.S. at 504 (acknowledging and analyzing the argument that Congress did not place express limitations on § 554).

119. *Midlantic*, 474 U.S. at 502 (majority opinion).

A. *Temporary Abandonment and Idle Iron*

Historically, oil and gas producers have been reluctant to permanently plug wells and decommission platforms until the final decommissioning regulatory requirements were triggered.¹²⁰ Even for Non-Producing wells and facilities, offshore E&P companies maintained that these properties added value to the lease or could one day be used to support other producing properties.¹²¹

However, in 2010, as part of the federal government's initiative to improve environmental health and safety of oil and gas production on the Outer Continental Shelf in the wake of the Deepwater Horizon disaster, BSEE published its Notice to Lessee (NTL) 2010-G05, entitled *Decommissioning Guidance for Wells and Platforms*, which is more commonly known as the "Idle Iron" policy.¹²² The purpose of the NTL was

to establish guidelines that provide a consistent and systematic approach to determine the future utility of idle infrastructure on active leases and to ensure that all wells, structures, and pipelines on terminated leases, and pipelines on terminated pipeline rights-of-way (ROW) are decommissioned within the timeframes established by regulations, conditions of approval, and lease instruments.¹²³

The term itself, "idle iron," refers to wells, platforms, and pipelines that are no longer producing or serving exploration, or that support functions related to a company's lease.¹²⁴ The policy is applicable to wells that need to be plugged, or platforms that need to be removed, because they are no longer useful for operations.¹²⁵

For offshore E&P debtors, idling wells, if done properly, could provide an avenue for delaying noncontingent P&A expenditures during the bankruptcy and altogether eliminate contingent future P&A work. Indeed, the so-called Idle Iron policy establishes an expectation that

120. Press Release, U.S. Dep't of the Interior, Interior Department Issues "Idle Iron" Guidance (Sep. 15, 2010), <https://www.doi.gov/news/pressreleases/Interior-Department-Issues-Idle-Iron-Guidance>.

121. *Id.*

122. *What Is the "Idle Iron" Policy and Why Does it Exist? FAQs*, BUREAU SAFETY & ENVTL. ENFORCEMENT, <https://www.bsee.gov/faqs/what-is-the-idle-iron-policy-and-why-does-it-exist> (last visited Nov. 9, 2017).

123. Lars T. Herbst, *Notice to Lessees and Operators of Federal Oil and Gas Leases and Pipeline Right-Of-Way Holders in the Outer Continental Shelf, Gulf of Mexico OCS Region*, U.S. DEP'T INTERIOR, BUREAU OCEAN ENERGY MGMT. (Sep. 15, 2010), <https://www.bsee.gov/sites/bsee.gov/files/notices-to-lessees-ntl/notices-to-lessees/10-g05.pdf>.

124. Press Release, *supra* note 120.

125. *What Is the "Idle Iron" Policy and Why Does it Exist? FAQs*, *supra* note 122.

facilities may be safely idled for a period of at least five years without posing an imminent threat to the public health and safety.¹²⁶ The procedures for temporary abandonment are set forth in 30 C.F.R. § 250.1721.¹²⁷ Read in conjunction with 30 C.F.R. § 250.1721, the Idle Iron policy provides bankruptcy courts ample support for the position that, unless otherwise proven by an objecting party, adherence to temporary abandonment guidelines should be sufficient to protect the public from any perceived imminent threat. In other words, requiring a debtor/trustee to temporarily abandon properties in accordance with § 250.1721 as a pre-condition to abandonment should satisfy the policy concerns espoused in *Midlantic*.

B. Incentivize the Rigs to Reef Program

BSEE's Rigs to Reefs program could also play a role in E&P bankruptcies, giving trustees an alternative to burdensome and costly P&A work. For a debtor who runs the risk of incurring substantial fines as a result of its failure to meet its P&A obligations, the Rigs to Reef program offers a very practical and cost-efficient solution.

The program began in 1984 with the passing of the National Fishing Enhancement Act in response to coastal states' concerns about losing the marine life that had developed around the artificial structures in the Gulf of Mexico.¹²⁸ It was warmly welcomed by conservationists and fishermen who recognized the social and economic value the oil and gas platforms could provide as artificial reefs.¹²⁹ According to BSEE's website, as of July 1, 2015, 470 platforms had been converted to permanent artificial reefs.¹³⁰ Converting a debtor's Non-Producing Properties into artificial reefs during the pendency of a bankruptcy could eliminate certain P&A obligations altogether while providing a potential environmental and recreational boon. The end result is a win-win situation for all interested parties. Specifically, the debtors would be relieved of P&A obligations, the disparate impact on other creditors would be reduced or eliminated altogether, and the government's objective of protecting (and even helping) the environment would be satisfied.

126. *Id.*

127. 30 C.F.R. § 250.1721 (2017).

128. *Rigs to Reefs*, BUREAU SAFETY & ENVTL. ENFORCEMENT, <https://www.bsee.gov/what-we-do/environmental-focuses/rigs-to-reefs> (last visited Nov. 8, 2017).

129. *Id.*

130. *Id.*

Still, the Rigs to Reefs program has not been without its detractors, and there are open questions regarding ownership and future liability of the rigs. The critics are mainly environmentalists who argue that leaving rusting steel rigs on the ocean floor could have a negative long-term impact on aquatic life and could create pollution.¹³¹ Regardless, the Rigs to Reef program has been widely viewed as the most practical alternative to full decommissioning, and in the bankruptcy context could be incredibly beneficial if debtors are permitted to utilize the program.

V. CONCLUSION

As many offshore E&P debtors have learned, the Gulf of Mexico is rich in natural resources. Unfortunately for their creditors and bankruptcy estates, there generally is not enough loot to go around. If bankruptcy courts continue with this broad policy of granting administrative priority to the government and other P&A claimants in such exorbitant amounts, the objectives underscoring the entire bankruptcy process are at risk of falling by the wayside. Giving this priority to the government and other P&A claimants results in secured creditors exiting the estate with the valuable property leaving the unsecured creditors to foot the bill. Such a result could not have been intended by *Midlantic* or the provisions of the Bankruptcy Code.

Midlantic's holding has been misapplied by a number of federal courts applying the case in the E&P context. This misapplication has resulted in a blockade of caselaw that acts to prevent the expeditious confirmation of chapter 11 plans. Moreover, the policy adopted in *H.L.S. Energy* and expanded upon in *American Coastal* has placed an unfair burden on debtors who enter bankruptcy seeking financial rehabilitation. Together, these cases have strung together a safety net for offshore regulators, such as BOEM and BSEE, who are charged with ensuring the financial viability of offshore E&P companies. By denying a significant bankruptcy power to E&P debtors, courts have allowed these offshore regulators to become more lax in their duties, while asserting massively underfunded P&A claims.

It is time we rethink this judicially created policy. Fresh ideas, such as Idle Iron and Rigs to Reef, are sorely needed. The current mechanisms for handling the P&A problem are simply not sustainable.

131. McKinney, *supra* note 99.