

Chapter 7

Common Issues in Oil and Gas Bankruptcy

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Synopsis

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Bankruptcy law gives a debtor numerous tools for wriggling free of burdensome obligations while retaining valuable property rights. The issues that can arise when a debtor owns mineral interests or is a party to oil and gas contracts, including operating agreements, are complex. While the underlying property rights are defined by state law, bankruptcy law allows certain modifications to those rights. A debtor’s actions thus can interfere with other parties’ expectations. A creditor or party to a contract with a potential debtor in an oil and gas bankruptcy should be prepared for—and protect against — some of the harsher potential outcomes. The following is a summary of the issues in a typical oil and gas bankruptcy case, along with practice pointers for parties dealing with debtors or potential debtors.

§ 7.01. Operating Agreements Are Executory Contracts.

The Bankruptcy Code allows a debtor to assume or reject an executory contract.² An executory contract is generally defined as a contract under which both sides still have material obligations to perform.³ If a contract is executory and the debtor decides that it is burdensome, bankruptcy law allows the debtor to get out of its obligations. If the contract is profitable, on the other hand, the debtor has the option to assume it.

Courts have uniformly held that an operating agreement (OA) is an executory contract.⁴ Because an OA is almost always an executory contract, the debtor may generally choose either to assume or reject an OA. The other

² 11 U.S.C. § 365.

³ *E.g.*, *Wilson v. TXO Production Corp. (In re Wilson)*, 69 B.R. 960, 962 (Bankr. N.D. Tex. 1987) (citing *In re Sunbelt Elec. Constructors, Inc.*, 56 B.R. 686, 688 (Bankr. N.D. Ga. 1986)) (“An executory contract is one under which the parties’ obligations to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.”).

⁴ *E.g.*, *Wilson*, 69 B.R. at 963 (joint operating agreement is an executory contract).