

Chapter 14

The Treatment of Oil and Gas Leases in the Context of Chapter 11 Bankruptcy Sales

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§ 14.01. Introduction.

As prices for domestic crude oil have continued the slide from 2014, and natural gas prices have languished, more and more oil and gas producers have joined the march to bankruptcy court. The year ending December, 2014 saw several small companies file for relief, and 2015, as of late July, has seen significantly larger companies joining them.¹

For cyclical businesses like oil and gas production, Chapter 11 bankruptcy can afford the type of temporary relief necessary to restructure debt obligations, jettison burdensome contracts, and adjust operations to reflect business realities, enabling the business to emerge from bankruptcy more fit to meet the economic challenges of the times. At least that’s the idea.

¹ Milagro Oil and Gas, Sabine Oil and Gas Corp. (\$2.5 billion in assets and 2.9 billion in debt), Quicksilver Resources (\$1.2 billion in assets and \$2.3 billion in debt), BPZ Resources, Dune Energy, American Eagle Energy Corp.

For a variety of reasons, some will face the liquidation of substantially all of their assets in Chapter 11, while others may actually turn to Chapter 11 as a vehicle to sell substantially all of their assets.

§ 14.02. How Does Chapter 11 Bankruptcy Facilitate Assets Sales in a Distressed Industry?

In the past one could assume, probably correctly, that buyers would be hard to come by in a distressed industry. Unstable markets, unreliable valuations, and fear of successor liability did little to attract buyers to an insolvent seller.

The bankruptcy courts offer mechanisms to address those concerns, and perhaps in part for that reason, the “distressed asset” market has become an industry in itself. A bankruptcy filing mandates disclosure by the debtor of substantial information that a buyer outside of bankruptcy may have to discover on its own. The automatic stay against creditor action and the protections afforded lenders and suppliers willing to do business with a Chapter 11 debtor help preserve the “going concern” value of the debtor’s business pending a sale.

The sales process is conducted according to published procedures authorized by the bankruptcy court and is fairly transparent. This process can be for the particular assets, industry, and exigencies at work. Bidders willing to serve as the “stalking horse” may receive economic incentives such as expense reimbursement and breakup fees.

Assets will be acquired without fear of fraudulent transfer claims after the sale. And, of greatest interest to buyers, a sale properly conducted according to 11 U.S.C. § 363 will be authorized by an order of the U.S. Bankruptcy Court declaring the assets to be sold free and clear of liens, claims, interests, and encumbrances.

Of equal importance to Section 363 in a sale of substantially all of the assets of a Chapter 11 debtor is Section 365. This section governs the assignment of certain of the debtor’s contractual rights. In the oil and gas production business, where the “going concern” value resides in the oil and