DEALING WITH COUNTERPARTY/BANKRUPTCY RISK IN THE UPSTREAM OIL AND GAS INDUSTRY

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CHAPTER 8

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Bruce J. Ruzinsky focuses his practice primarily on representing financial institutions, corporations, and other business entities in workout/restructure efforts, chapter bankruptcy proceedings, and litigation.

Mr. Ruzinsky has approximately 30 years' experience in representing creditors, creditors' committees, trustees, debtors, landlords, and/or asset purchasers in various industries and business environments, including energy, real estate, shipping, manufacturing, transportation, retail, entertainment, wholesale produce, heath care, and personal services. He was extensively involved in representing large creditors in the R&R Marine, Kimball Trading, TransTexas and TriUnion cases, the contract operator in the McKenzie Methane case, the Official Unsecured Creditors Committee in the first Continental Airlines case, the Indenture Trustee in the Seven Seas Petroleum and Eagle Geophysical cases, agent banks in the Global Marine, Southern Mineral and North American Petroleum cases, and the letter of credit issuing bank in the Osyka case. He also represented large creditors in the Enron, Durango, Tekoil and Seahawk cases, and the Chairman of the Official Unsecured Creditors Committee in the Panaco case.

Mr. Ruzinsky has litigated a wide variety of issues in Chapter 11 cases, including involuntary petition, cash collateral, DIP lending, automatic stay, sale/sale procedures, avoidance action, turnover, discharge/dischargeability, exemption, dismissal/conversion, abstention, executory contract/lease, Trustee/Examiner/CRO, proof of claim, Safe Harbor Provisions and plan confirmation issues.

MEMBERSHIPS

Mr. Ruzinsky has served on the Chapter 11 Advisory Committee for the Southern District of Texas, and is a member of the Houston Bar Association (past Chairman of the Bankruptcy Section and

BRUCE J. RUZINSKY

past Co-Chair of the Committee on Minority Opportunities in the Legal Profession), the Houston area bankruptcy Inn of Court (Past President), the State Bar of Texas, and the American Bankruptcy Institute.

COMMUNITY INVOLVEMENT

Mr. Ruzinsky serves on the Houston area Duke University Alumni Admissions Advisory Committee having chaired or co-chaired it for over 20 years and is a past member of the Board of Directors of the Duke University Alumni Association. He is a member of the Greater Houston Partnership and the Tournament Committee for the Nicholas Alexander Higgins Memorial Golf Tournament benefiting Texas Children's Hospital. He also has handled pro bono matters for the Houston Volunteer Lawyers Program..

AWARDS

Mr. Ruzinsky is included in the 2012-2015 editions of *Chambers USA: America's Leading Lawyers for Business* under Bankruptcy/Restructuring. Mr. Ruzinsky was named a "Super Lawyer" (2003-2014) by Thomson Reuters. He has also been named a "Top Lawyer" by *H Texas* magazine. He is included in the *The Best Lawyers in America* under Bankruptcy and Creditor-Debtor Rights Law/ Insolvency and Reorganization Law (2008-2015) and under Litigation – Bankruptcy (2012-2015).

ADMITTED

- Texas
- United States Court of Appeals for the Fifth Circuit
- United States Court of Appeals for the Eleventh Circuit
- United States District Court for the Northern District of Texas
- United States District Court for the Southern District of Texas
- United States District Court for the Eastern District of Texas
- United States District Court for the Western District of Texas

EDUCATION

Mr. Ruzinsky received his B.A. degree, *magna cum laude*, and his J.D. degree from Duke University.

PUBLICATIONS & SPEAKING ENGAGEMENTS

He has authored or co-authored various articles on such bankruptcy related topics as purchasing assets from the debtor's estate, post-petition lending, setoffs and constructive trusts, and general bankruptcy considerations in connection with foreclosure and repossession.

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AV Martindale-Hubbell Peer Review Rated

Monica Blacker has extensive experience assisting clients in recovering their money and collateral when borrowers default or file for bankruptcy. She also regularly represents secured and unsecured creditors and debtors in restructurings. She takes a collaborative approach to her practice with the goal of obtaining the highest possible recovery for her clients in an efficient and cost-effective manner.

Ms. Blacker routinely represents clients in court proceedings and out-of court restructurings and has played a leading role in a number of significant restructurings. A few recent examples include:

- Represents the largest unsecured trade creditor and co-chair of the Official Committee of Unsecured Creditors in the Chapter 11 proceedings of Energy Future Holdings, Corp. (formerly TXU)
- On behalf of a secured creditor, secured full recovery on a $492 million loan in the PJ Finance Chapter 11 proceeding
- Restructured over $50 million of debt on behalf of secured lender in Villagio Partners Chapter 11 proceeding
- Represents several large institutional landlords in bankruptcy proceedings in Texas, New York, and Delaware

Ms. Blacker's accomplishments on behalf of clients have earned her recognition in the ***US Legal 500*** as a Leading Corporate Restructuring Lawyer in the U.S. and by ***ALM*** as one of Texas' Top Rated Lawyers in Bankruptcy.

In addition to her particular experience representing secured lenders, Ms. Blacker has assisted clients with a broad range of restructuring matters, including:

MONICA S. BLACKER

- Representing debtors, secured and unsecured creditors, and creditors' committees in Chapter 11 bankruptcy proceedings
- Representing secured lenders in real estate-related out-of-court workouts and foreclosures
- Representing master and special servicers on behalf of trustees in commercial mortgage-backed securities (CMBS) transactions
- Representing lenders and servicers in significant loan assumptions and loan modifications both in and out of court
- Representing buyers in multiple distressed asset purchases in and out of court

Ms. Blacker has worked with clients in a variety of industries, including real estate, energy, banking, communications, restaurants, technology, manufacturing, and transportation (trucking and air). She practices before courts in Texas, Delaware, Delaware, North Carolina, Louisiana, Illinois, and other states.

AWARDS

- Leading Corporate Restructuring Lawyer in the United States, ***The US Legal 500*** (2012)
- Texas' Top Rated Lawyers in Bankruptcy, ***ALM*** (2012)
- Texas Rising Star, Thomson Reuters (2011)
- Dallas Volunteer Attorney Program's Finest

COMMUNITY INVOLVEMENT

- Women on the Move Luncheon benefiting National MS Society, Host Committee Member and Committee Chair
- Cancer Support Community North Texas (formerly Gilda's Club), Board of Directors
- Cancer Support Community One Run 2013 Chair
- Annual Fund Captain, St. John's Episcopal School

ADMITTED

- Texas, 1996
- U.S. District Court for all Texas districts
- U.S. Bankruptcy Court for all Texas districts
- U.S. Court of Appeals for the Fifth Circuit

MEMBERSHIPS

- Texas Bar Foundation, Fellow

MONICA S. BLACKER

- Dallas Bar Association, Bankruptcy and Commercial Law Section, Past Chair
- State Bar of Texas
- American Bankruptcy Institute, Real Estate Section

EDUCATION

Ms. Blacker received her B.B.A., ***cum laude,*** from James Madison University, and received her J.D., ***cum laude,*** from Southern Methodist University's Dedman School of Law.

PUBLICATIONS & SPEAKING ENGAGEMENTS

Ms. Blacker has presented the following:

- "Business: What's Hot and Trendy in Debt and Equity Financing," co-presented at the 11th Anniversary Texas Bench/Bar Bankruptcy Conference (2015)
- "Dealing With Counterparty / Bankruptcy Risk in the Upstream Oil and Gas Industry," co-presented to lawyers and in-house counsel (2015)
- "When the Shoe Doesn't Fit: Unusual Valuation Issues," co-presented at the 32nd Annual Advanced Business Bankruptcy Seminar (2015)
- "Structured Dismissals: The Least Worst Option?" presented to the Dallas Bar Association Bankruptcy & Commercial Law Section (2014)
- Presentation to clients regarding Landlord & Tenant Bankruptcy Issues
- "Technology in the Courtroom," co-presented at the Trial Academy of the Texas Access to Justice Commission, The University of Texas School of Law (2008)
- "Bankruptcy, What's New?" co-presented to the North Texas Paralegal Association, Belo Mansion (2008)

Ms. Blacker has written the following:

- "Structured Dismissals: The Least Worst Option?" (2014)
- "Receivership," ***Trigild Bestbook, 4th Edition*** (2012)
- "Payments by Enron are 'Settlement Payments' under the Bankruptcy Code's Safe Harbor Provisions" (July 2011)
- "The Rejectability of Arbitration Clauses: Part II" ***American Bankruptcy Institute Journal*** (June 2007)
- "The Rejectability of Arbitration Clauses" ***American Bankruptcy Journal*** (April 2007)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

DEALING WITH COUNTERPARTY/BANKRUPTCY RISK IN THE UPSTREAM OIL AND GAS INDUSTRY

I. Practices for Reducing Counterparty Risk (Pre-bankruptcy planning)

A. Perfecting Rights Relating to Oil and Gas Leases, JOAs

i. Operators' Liens

Operators' liens arise under joint operating agreements to secure unpaid obligations of non-operating owners. Typically, operators are granted a security interest on the oil and gas property covered by the leasehold as well as a security interest in all oil and gas production, including proceeds. An unrecorded joint operating agreement could be the target of an avoidance claim by a debtor. A potential method of recording operators' liens is via the filing of a summary of the operating agreement in the appropriate real property records for notice. *See Westland Oil Development Corp. v. Gulf Oil*, 637 S.W.2d 903 (Tex. 1983).

ii. Non-operators' Liens

State law gives rise to liens for non-operators, including those who provide labor, services, and equipment for work related to "mineral activities" or the "drilling of wells. *See* Tex. Prop. Code § 56.002 (Vernon 2002).[1] Under Texas law, a mineral contractor has six months after the day the indebtedness accrues in which to file an affidavit with the county clerk of the county in which the property is located. *See* TEX. PROP. CODE § 56.021(a). Furthermore, § 56.005 sets forth when indebtedness accrues. Section 56.005(a) provides that the indebtedness for *labor performed* accrues at the end of each week during which the labor is performed, and § 56.005(b) sets forth that indebtedness *for material or services* accrues on the date the material or services were last furnished. Although the automatic stay operates to prevent all activity to collect prepetition debts from the debtor or assert or enforce claims against the debtor's prepetition property, including creating, perfecting, or enforcing a lien against the property of the debtor, § 362(b)(3) and § 546(b)(1) operate to create an exception for mechanics and materialmen's' liens.

iii. Protecting non-consent rights/penalties

B. Analyzing Rights Under JOAs or Other Operative Agreements

Courts have characterized joint operating agreements as executory contracts subject to assumption or rejection by a debtor. *See Wilson v. TXO Production Corp. (In re Wilson)*, 69 B.R. 960 (Bankr. N.D. Tex. 1986). In *Wilson*, the court held that an executory contract is not enforceable against a debtor prior to its assumption. *See id.* at 966. Accordingly, prior to the debtor's assumption of the joint operating agreement, the non-debtor party is still obligated to perform its contractual obligations although the debtor is not similarly obligated to perform. *In re El Paso Refinery L.P.*, 220 B.R. 37, 43 (Bankr. W.D. Tex. 1998). In exchange for performance, the counterparty can assert an administrative claim for the reasonable value of its performance.

C. Obtaining and Recording Assignments of Interest, Related Issues

D. Other Credit Protections / Financial Accommodations

E. Producer's Lien Statutes – Possible Traps

Many jurisdictions grant statutory liens to protect sellers of hydrocarbons so that sellers have a secured claim for hydrocarbons sold but not paid for as of the petition date of a bankruptcy. *See* TEX. BUS. & COM. CODE § 9.343(Vernon 2005). Some states, such as Texas, provide for automatic perfection of such liens. Statutory liens in Texas that attach to proceeds of oil and gas production cannot be avoided by a debtor relying on § 544(a)(3) of the Bankruptcy Code. *In re Tri-Union Development Corp.*, 253 B.R. 808 (Bankr. S.D. Tex. 2000) (holding that statutory liens arising under §9.343 held by royalty and working interest owners and attached to account proceeds of production are not susceptible to invalidation by a bona fide purchaser).

[1] Section 56.002 provides that "[a[mineral contractor or subcontractor has a lien to secure payment for labor or services related to the mineral activities."

In *J. Aron & Co. v. SemCrude, LP (In re SemCrude, LP),* No. 14-cv-41, 2015 U.S. Dist. LEXIS 99453 (D. Del. July 30, 2015) a group of producers had filed claims in the bankruptcy case for oil delivered to the debtor prior to the bankruptcy filing and filed adversary proceedings against purchasers, alleging that the purchasers violated the producers' liens in the oil. Various producers from different states sought declaratory judgments concerning their asserted lien claims against the debtors and the debtors' secured lenders. *Id.*

The court ruled in favor of the purchasers, holding that they took free and clear of the producers' liens in the oil and gas and thus the producers could not recover from the purchasers, disagreeing with the purchasers' arguments that certain provisions of Texas law provided them with automatically perfected liens. *Id.* at *28. In so concluding, the court reasoned that the purchasers were buyers for value under the UCC and therefore took the oil and gas free and clear of prior liens of which the purchasers had no actual knowledge and which had not been perfected prior to delivery of the subject oil and gas. *See id.*

F. **Dealing with Insolvent Contractors – Oil Well Lien Statutes**

Recent Texas law has provided that oil and gas operators subject to threatened liens by drilling contractors' subcontractors have a right to protect property from liens and encumbrances through temporary injunction. *Adobe Oilfield Services, Ltd. v. Trilogy Operating, Inc.,* 305 S.W.3d 402 (Tex. App.—Eastland 2010, no pet.). In *Adobe Oilfield,* the court held that injunctive relief should be granted to prevent threatened liens from being filed by the drilling contractor's subcontractors.

G. **Preference Concerns in Connection with Perfecting Rights**

The Bankruptcy Code empowers the debtor (or trustee) to avoid preferences. A transfer is preferential and may be avoided if it is (i) to or for the benefit of a creditor; (ii) on account of an antecedent debt; (iii) made while the debtor is insolvent; (iv) made on or within ninety days of the petition date or within one year if the creditor at the time of the transfer was an insider; and (v) allows the creditor to receive more than the creditor would receive in a chapter 7 liquidation. *See* § 547(b).

In addition, the Bankruptcy Code defines the term "transfer" broadly, to include the creation of a lien, the retention of title as a security interest, the foreclosure of a debtor's equity of redemption; or "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of or disposing or party with (i) property; or (ii) an interest in property." *See* § 101(54). Thus, a recordation of a mortgage is a transfer for purposes of § 547. *In re Airport-81 Nursing Care, Inc.,* 29 B.R. 501 (D. E.D. Tenn. 1983). Thus, if a mortgage has been granted and funds advanced prior to ninety days before the petition date, but the mortgage not recorded, later recordation of the mortgage within ninety days of the petition date may constitute a preference and be avoided by the debtor. *Id.* at 509. The same result occurs if a defective mortgage is filed outside of the ninety-day period, but an act of correction is filed within the ninety-day period.

H. **Special Protections/ Safe Harbors – Farmouts, Forward Contracts, Production Payments**

A farmout agreement is a contractual agreement pursuant to which an owner of a lease (farmor) agrees to assign some or all of its interest in the property to another party (farmee) in exchange for the performance of certain tasks, such as drilling wells.[2]

Notably, the Bankruptcy Code carves out some property from the reach of property of the estate. In particular, § 541(b)(4) limits the definition of property of the estate to exclude the following:

[2] In § 101(21A), the Bankruptcy Code defines a "farmout agreement":

(21A) "farmout agreement" means a written agreement in which –

(A) the owner of a right to drill, produce, or operate liquid or gaseous hydrocarbons on property agrees or has agreed to transfer or assign all or a part of such right to another entity; and

(B) such other entity (either directly or through its agents or its assigns), as consideration, agrees to perform drilling, reworking, recompleting, testing or similar or related operations, to develop or produce liquid or gaseous hydrocarbons on the property.

> [A]ny interest of the debtor in liquid or gaseous hydrocarbons to the extent that (A)(i) the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement and; (ii) but for operation of this paragraph, the estate could include the interests referred to in clause (i) only by virtue of section 365 of 544(a)(3) of this title; or (B)(i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and (ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 542 of this title.

Section 541(b)(4) eliminates a potential windfall to a debtor-farmor under a farmout agreement because otherwise, if the debtor is a farmor and the farmee has drilled a producing well, the debtor could reject the farmout agreement rather than accepting the contract and recognizing the farmee's interest. Section 541(b)(4) excludes from property of the estate any interest in liquid or gaseous hydrocarbons that the debtor "has transferred or agreed to transfer" pursuant to a farmout agreement and thereby extinguishes the debtor-farmor's ability to eradicate the farmee's right to receive title to what it earned on the petition date by rejecting the farmout agreement under § 365 of the Bankruptcy Code. In addition, § 541(b)(4)(A)(ii) further provides that a farmee's right to assignment of title under a farmout agreement, if properly earned, is not destroyed simply because the farmee's interest is not of record on the petition date.

A finding that an agreement is a forward contract implicates certain "safe harbor" provisions of the Bankruptcy Code. Among these is the "safe harbor" protection afforded by § 546(e) of the Bankruptcy Code. *Williams v. Morgan Stanley Capital Grp., Inc. (In re Olympic Natural Gas Co.)*, 258 B.R. 161 (Bankr. S.D. Tex. 2001), *aff'd* 294 F.3d 737 (5th Cir. 2002). This safe harbor provision protects against a bankruptcy trustee's ability to recover and avoid preferential or constructively fraudulent transfers under §§ 544, 547, and 548(a)(1)(B) of the Bankruptcy Code, by virtue of § 546(e), although it would not prevent a suit for recovery of an actually fraudulent transfer under § 548(a)(1)(A). *GPR Holdings, L.L.C. v. Duke Energy Trading and Mktg, L.L.C. (In re GPR Holdings)*, 316 B.R. 477 (Bankr. N.D. Tex. 2004).

The Bankruptcy Code defines the term "forward contract" in § 101(25) as follows:

> (A) <u>a contract</u> (other than a commodity contract, as defined in section 761) <u>for the purchase, sale, or transfer of a commodity</u>, as defined in section 761(8) of this title, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade or product or byproduct thereof, <u>with a maturity date more than two days after the date the contract is entered into</u>, including, but not limited to, a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement" as defined in this section) consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any similar agreement. (emphasis supplied).

Looking at such definition of "forward contract," courts have noted that in general terms, "forward contracts" are contracts for the future purchase or sale of commodities that are not subject to the rules of a contract market or board of trade. *Superior Livestock Auction, Inc. v. E. Livestock Co., LLC (In re E. Livestock Co., LLC)*, No. 10-93904, 2012 Bankr. LEXIS 1469 (Bankr S.D. Ind. Apr. 5, 2012) (holding that contracts for the purchase and sale of cattle for future delivery were forward contracts); *Williams v. Morgan Stanley Capital Grp., Inc. (In re Olympic Natural Gas Co.)*, 258 B.R. 161 (Bankr. S.D. Tex. 2001), *aff'd* 294 F.3d 737 (5th Cir. 2002) (holding that contracts for the purchase and sale of a certain, specified quantity of natural gas to be delivered physically at some certain, specified future date constituted forward contracts.).

In addition, in § 101(26), the Bankruptcy Code defines "forward contract merchant" as follows:

> [A] Federal reserve bank, or an entity the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity (as defined in section 761) or any similar good, article, service, right, or interest which is present or in the future becomes the subject of dealing in the forward contract trade.

In determining whether a particular contract constitutes a "forward contract," bankruptcy and appellate courts have varied in their approaches. Some courts have looked for a contract to have "financial characteristics" in order for the contract to constitute a forward contract. *Buchwald v. Williams Energy Mktg. & Trading Co. (In re Magnesium Corp. of Am.)*, 460 B.R. 360 (Bankr. S.D.N.Y. 2011) (remarking that several courts have considered a contract's financial character). Other courts, including the Fifth Circuit, however, have not considered a contract's financial character. *See, e.g., Williams v. Morgan Stanley Capital Group (In re Olympic Natural Gas Co.)*, 294 F.3d 737 (5th Cir. 2002); *Lightfoot v. MXEnergy Elec., Inc. (In re MBS Mgmt. Servs.)*, 690 F.3d 352 (5th Cir. 2012) (rejecting argument that "ordinary supply contracts' cannot qualify as forward contracts under the statute).

With respect to the particular characteristics required of a contract in order for it to constitute a forward contract under the Bankruptcy Code, courts have reached differing results. Recently, the Fifth Circuit, in *Lightfoot v. MXEnergy Elec., Inc. (In re MBS Mgmt. Servs., Inc.),* 690 F. 3d 352 (5th Cir. 2012), ruled that a contract that contained no fixed quantity or delivery dates qualified as a forward contract. In addition, the bankruptcy court in *Liquidating LLC v. Brideline Gas Mkgt., LLC (In re Borden Chems. & Plastics Operating Ltd. P'ship)*, 336 B.R. 214 (Bankr. D. Del. 2006), held that a natural gas supply contract was a forward contract even though it contemplated actual delivery of the gas, and did so based upon the plain language in § 101(25).Finally, courts have also expressed uncertainty with respect to the meaning of "maturity date" included in § 101(25). *Superior Livestock Auction, Inc. v. E. Livestock Co.*, 2012 Bankr. LEXIS 1469, *15-16 (noting that no court has explicitly defined the term "maturity date.").

In addition to protection from avoidance actions, a party to a forward contract who is a forward contract merchant may immediately set off or net amounts owed to it in respect of a claim against the debtor for a settlement payment, notwithstanding the imposition of the automatic stay. *See* 11 U.S.C. § 362(b)(6). Section 362(b)(6) provides that the automatic stay will not apply to a setoff by a commodity broker or forward contract merchant of any mutual debt and claim under or in connection with any forward contract. *GPR Holdings, L.L.C. v. Duke Energy Trading and Mktg, L.L.C (In re GPR Holdings)*, 316 B.R. 477 (Bankr. N.D. Tex. 2004).A motion for relief from the automatic stay is thus not required, although it otherwise would be required in order to exercise a right to setoff. *See* 11 U.S.C. § 362(a)(7) (providing that the stay applies to the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor).

An additional advantage provided by the Bankruptcy Code to counterparties to a forward contract is that forward contracts are an exception to the *ipso facto* clause prohibition. An *ipso facto* clause refers to a contractual provision that allows a party to liquidate a contract upon the filing of a bankruptcy by the counterparty and is generally unenforceable under the Bankruptcy Code. *See Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007-1 Ltd. (In re Lehman Bros. Holdings, Inc.),* 452 B.R. 31, 38 (Bankr. S.D.N.Y. 2011). Liquidated damages provisions in an agreement typically provide the sole and exclusive remedy under an agreement. However, the bankruptcy safe harbor provisions also allow a non-defaulting party to a forward contract to terminate a contract based upon the counterparty's act of filing a bankruptcy petition, thus enforcing the *ipso facto* clause. Early termination rights under an agreement typically arise upon an event of default and permit a contractual counterparty to, among other things, terminate outstanding transactions or suspend payment and performance obligations under the agreement. Ordinarily, such contractual rights would be unenforceable against a debtor pursuant to § 365(e)(1). But, § 556 provides as follows:

> The <u>contractual right</u> of a commodity broker or <u>forward contract merchant to cause the liquidation</u> of a commodity contract, as defined in § 761(4), or <u>forward contract</u> because of a condition of the kind specified in § 365(e)(1) of this title and the right to a variation or maintenance margin payment received from a trustee with respect to open commodity contracts or forwarded contracts, <u>shall not be stayed, avoided or otherwise limited by operation of any provision of this title</u> or by the order of a court in any proceeding under this title.

Thus, § 556 permits a "forward contract merchant" to liquidate a forward contract without court approval if the liquidation is based upon a contractual provision providing for default upon a counterparty becoming a debtor in bankruptcy if the liquidation of the forward contract is based upon a debtor's filing of a bankruptcy petition in exercise of a prepetition contractual right. *See Calpine Energy Servs., L.P. v. Reliant Energy Electric Solutions, L.L.C.*, 2009 Bankr. LEXIS 1041, at *18 (Bankr. S.D.N.Y. May 7, 2009).

II. Post-bankruptcy Basics

A. Creditor (Secured or Unsecured) or Owner? Bankruptcy Priorities

Section 507(a) of the Bankruptcy Code sets forth categories of claims that are entitled to priority in bankruptcy cases. The priority scheme in bankruptcy dictates the order in which claims are paid. Section 507(a)(1) grants a first priority to "administrative expenses allowed under § 503(b)." Section 503(b)(1)(A) in turn defines "administrative claims" to mean "the actual, necessary costs and expenses of preserving the estate." Administrative claims include the costs of the bankruptcy, including fees for professionals who represent the estate. Section 507(a)(3) provides a limited priority claim for wage claims of employees and its companion, § 507(a)(4), provides a limited priority claim for claims under employee benefit plans.In addition, priority status is granted to certain unsecured tax claims.

B. Reclamation Rights and 503(b) Claims

Reclamation rights arise under the Uniform Commercial Code ("UCC"). Section 2.702(b) of the TEX. BUS. & COM. CODE provides as follows:

> Where the seller discovers that the buyer has received goods on credit while insolvent, he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent representation of solvency or of intent to pay.[3]

Under Texas's and most state's UCC provisions, a seller utilizing reclamation can only reclaim goods delivered within ten (10) days of notice. Once a bankruptcy is filed, § 546(c) of the Bankruptcy Code provides that reclamation

[3] Section 2.702(c) further provides that the seller's right to reclaim under subsection (b) "is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this chapter (Section 2.403)."

demands are excepted from the automatic stay.Section 546(c) provides as follows:

> (1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—
>
> (A) not later than 45 days after the date of receipt of such goods by the debtor; or
>
> (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

Bankruptcy courts have held that § 546(c) functions to provide a safe harbor protecting state law reclamation rights upon the filing of a bankruptcy, but does not create substantive rights of reclamation. *See In re Dana Corp.*, 367 B.R. 409 (S.D.N.Y. 2007). The right of a reclaiming seller to recover an administrative claim is found in §503(b)(9) of the Bankruptcy Code. Section 503(b)(9) provides as follows:

> After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(g) of this title, including –
>
> (9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

Section 503(b)(9) operates to grant entitlement to an administrative expense claim to a seller for good that were received by the debtor within 20 days of the commencement of the case and sold in the ordinary course of the debtor's business. *See Phar-Mor, Inc. v. McKesson Corp.,* 534 F.3d 502, 508 (6th Cir. 2008). Hydrocarbons are "goods" for the purposes of § 503(b)(9). *In re Pilgrim's Pride Corp*, 421 B.R. 231 (Bankr. N.D. Tex. 2009) (holding that Congress could have excluded utilities and mineral suppliers from § 503(b)(9), but did not). The court in *Pilgrim's Pride* also addressed valuing the goods received by the debtor within twenty (20) days of the bankruptcy case for § 503(b)(9). In determining the value of the natural gas received by the debtors, the court in *Pilgrim's Pride* ruled that the gas seller's administrative claim should be based on the amount the debtors would have had to pay to purchase natural gas on the open market during the twenty (20) day period. *Id.*

C. **Automatic Stay**

The filing of a petition for relief under the Bankruptcy Code immediately operates as an automatic stay of "the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case." §362(a)(1).Thus, any act to collect, assess, or recover a claim against the debtor that arose prior to the filing of the petition is a violation of the automatic stay. *See* § 362(a)(6); *See, e.g., In re Solutia, Inc.,* 379 B.R. 473, 485 n.8 (Bankr. S.D.N.Y. 2007). Further, the automatic stay prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." § 362(a)(3).

D. **Property of the Estate**

The commencement of a bankruptcy case creates an estate. The estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case pursuant to § 541 of the Bankruptcy Code. *Fowler v. Shadel*, 400 F.3d 1016, 1018 (7th Cir. 2005). What constitutes property of the estate is a federal question under the Bankruptcy Code, but whether and to what extent a debtor has any legal or equitable interest in particular property may be determined under state law. *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993) (citing *Butner v. United States*, 440 U.S. 48, 59 L. Ed. 2d 136, 99 S.Ct. 914 (1979)). Section 541 includes the debtor's interest in both tangible and intangible property. *Shimer v. Fugazy (In re Fugazy Express, Inc.)*, 114 B.R. 865, 869 (Bankr. S.D.N.Y. 1990), *aff'd* 124 B.R. 426 (S.D.N.Y. 1991).

E. **Actions Stayed**

There is no question that any act to obtain or enforce a judgment is a violation of the automatic stay. Pursuant to the provisions of § 362(a)(6) of the Bankruptcy Code, a chapter 11 petition operates as a stay of "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." *See, e.g., In re Solutia Inc.*, 379 B.R. 473, 485 n.8 (Bankr. S.D.N.Y. 2007). In fact, if relief from the automatic stay is not first obtained, judicial actions and proceedings against the debtor are void *ab initio. See Maritime Elec. Co., Inc. v. United Jersey Bank,* 959 F.2d 1194, 1206 (2d Cir. 1991).

As *Maritime Elec. Co.* observed, "holding that judicial acts and proceedings in violation of the automatic stay are void *ab initio* is consistent with the stay's function of 'enab[ling] the bankruptcy court to decide whether it will exercise its power under § 502(b) of the Bankruptcy Code to establish the validity and amount of claims against the debtor or allow another court to do so, thereby preventing a chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts." *Id.* at 1207 (quoting *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5th Cir. 1986)); *Gilchrist v. General Elec. Capital Corp.*, 262 F.3d 295 (4th Cir. 2001). The automatic stay, however, does not prevent the filing of notices or affidavits that are a prerequisite to perfecting a statutory oil and gas contractor's lien. *In re Houts,* 23 B.R. 705 (Bankr. W.D. Mo. 1982); *In re Yobe Elec. Inc.*, 30 B.R. 114, 116-18 (Bankr. W.D. Pa. 1983).

F. **Usage of Cash Collateral, DIP Financing**

Cash collateral concerns two basic questions: (1) whether a creditor has a claim or interest that should be protected while a debtor uses cash collateral; and (2) if a creditor has a claim or interest deserving of adequate protection, the appropriate measure of adequate protection for the diminution in collateral caused by a debtor's use. *In re Residential Capital LLC*, 501 B.R. 549, 590 (Bankr. S.D.N.Y. 2013). Notwithstanding state law, the Bankruptcy Code gives a lien claimant an interest in cash collateral if it is the "proceeds" of property in which the clamant has a security interest. Section 363(a) states: "[C]ash collateral' means cash, . . . or other cash equivalents whenever acquired . . . and includes the proceeds, products, offspring, rents, or profits of property . . . subject to a security interest as provided in § 552(b) of this title." Importantly, §552(b) is limited to consensual security interests.

Section 363(b)(1) expressly authorizes a debtor, after notice and a hearing, to use, other than in the ordinary course of business, property of the estate, including cash collateral. Such provision empowers a bankruptcy court to approve a debtor's use of cash collateral over the objection of a party with an interest in cash collateral. Section 361 of the Bankruptcy Code, in turn, addresses the means by which adequate protection may be provided when a debtor's use of cash collateral is prohibited or conditioned. Section 361 does not include a prohibition or condition preventing the use of cash collateral in the debtor's exercise of its avoidance powers. *See* § 361(1)-(3).

Although the debtor bears the initial burden of proof as to the issue of adequate protection, "in all cases, the creditor bears the burden in the first instance of establishing the amount and extent of its lien under § 506(a)." *Id.* at 590 (citing *In re Heritage Highgate, Inc.*, 679 F.3d 132, 140 (3d Cir. 2012) (holding that "the ultimate burden of persuasion is upon the creditor to demonstrate by a preponderance of the evidence both the extent of its lien and the value of the collateral securing its claim."). If a creditor carries its burden, and the amount and extent of a secured claim has been established, the burden shifts to a debtor seeking to use, sell, lease, or otherwise encumber such creditor's collateral pursuant to §§ 363 or 364 to prove that the secured creditor's interest is adequately protected. *Id.* (citing *Wilmington Trust Co. v. AMR Corp. (In re AMR Corp.),* 490 B.R. 470, 477-78 (S.D.N.Y. 2013).

G. **Executory Contracts/Leases**

A debtor can assume or reject an unexpired lease or executory contract under §365(a) of the Bankruptcy Code, subject to a few exceptions and court approval.Issues arise as to whether particular sorts of routine agreements in the oil and gas industry qualify as executory contracts as opposed to a vested property right. While the term "executory contract" is not defined in the Bankruptcy Code, court have accepted the following definition: a contract is executory if the obligations of both parties are so far unperformed that the failure of either party to perform would be a material breach. *In re Liljeberg Enters., Inc.,*304 F.3d 410, 436 (5th Cir. 2002). Contracts that are not executory are considered to be the bankruptcy estate's property under § 541 or a basis for a prepetition claim (if the debtor has not performed).

Once the executoriness of an agreement has been established; however, the decision to assume or reject an executory contract is left to the business judgment of the debtor. *Mirant Corp. v. Potomac Electric Power Co. (In re Mirant Corp.),* 378 F.3d 511, 524, n.5 (5th Cir. 2004). An executory contract may not be assumed in party and rejected in part. *In re Abitibibowater Inc.,* 418 B.R. 815 (Bankr. D. Del. 2009); *Stewart Title Guaranty Co. v. Old Republic Nat'l Title Ins. Co.,* 83 F.3d 735, 741 (5th Cir. 1996). Instead, the debtor or the bankruptcy trustee must assume the entire contract or reject the entire contract. *See NLRB v. Bildisco v. Bildisco,* 465 U.S. 513, 531 (1984); *In re National Gypsum Co.,* 208 F. 3d 498, 506 (5th Cir. 2000).

1. **Character of Oil and Gas Leases**

Whether a contract should be deemed executory is a question of federal law. *See In re Alexander*, 670 F.2d 885 (9th Cir. 1982). The question of whether an oil and gas lease constitutes an executory contract depends upon the treatment of the type of interest created under applicable state law, so the treatment of a particular oil and gas lease differs from state to state.

An oil and gas lease under Texas law is not an executory contract that a debtor may accept or reject in its bankruptcy proceeding. Also, an oil and gas lease under Texas law is not a lease of non-residential real property that can be assumed or rejected under §365. Bankruptcy courts examining Texas law have held that an oil and gas lease is not a contract, but instead is a conveyance of an ownership interest in real property. *See Anadarko Petroleum Corp. v. Thompson,* 94 S.W.3d 550, 554 (Tex. 2002). Similar to Texas law, under Oklahoma law, an oil and gas lease is a fee estate in real property. *In re Heston Oil Co.,* 69 B.R. 34, 36 (N.D. Okla. 1986). Accordingly, § 365 does not apply to Texas and Oklahoma oil and gas leases. *Id.*

Louisiana courts have not definitively decided whether an oil and gas lease is an executory contract subject to § 365. In *Texaco Inc. v. Louisiana Land Exploration Co.,* 136 B.R. 658, 668 (M.D. La. 19992), the court held that the subject oil and gas lease was an executory contract upon the debtor's request to assume it, but in *In re WRT Energy Corp.,* 202 B.R. 579, 583 (W.D. La. 1996), the bankruptcy court held the oil and gas mineral lease there was not a lease or executory contract within the meaning of § 365.

The North Dakota bankruptcy court recently affirmed in *Great Plains Royalty Corp. v. Earl Schwartz Co.,* No. 68-00039, 2015 Bankr. LEXIS 883, at * 52-54 (Bankr. N.D. March 18, 2015) that oil and gas leases are interests in real property in North Dakota, although it made no §365 determinations.

Courts generally hold that an oil and gas lease is a license under Ohio law rather than a deed of conveyance, although there is contrary authority. *Wellington Res. Group LLC v. Beck Energy Corp.,* 975 F. Supp. 2d 833, 838 (S.D. Ohio 2013) (holding that oil and gas leases are not "real estate" under Ohio law and instead create a license to enter upon the land for exploration and drilling for oil and gas lease).

In addition, with respect to oil and gas leases under Pennsylvania law, the law is unsettled. The Pennsylvania bankruptcy court in *In re Powell,* 482 B.R. 873, 878 (Bankr. M.D. Pa. 2012) held that no real property interest is conveyed in an oil and gas lease. The lessees objected to the debtor's motion to reject, arguing that because the oil and gas lease was neither a lease nor an executory contract, it could not be rejected. *Id.* at 875. The *Powell* court observed that if production had occurred, such production would have vested the lessee with a fee simple determinable interest, and the executory nature of the lease would have terminated. *Id.* at 875-77. The *Powell* court did not outright decide whether § 365 applied because the oil and gas lease was executory, but instead held that even it if was, the debtor failed to demonstrate sufficient justification for rejection. *Id.* at 878.

2. **JOAs**

Courts hold that joint operating agreements are executory contracts subject to assumption or rejection by the debtor. *In re Panaco, Inc.*, No. 02-37811-H3-11, 2002 Bankr. LEXIS 2084 (Bankr. S.D. Tex. Dec. 10, 2002). Prior to assumption, an executory contract, including a JOA, is enforceable *by* the debtor and not *against* the debtor. *In re El Paso Refinery L.P.*, 220 B.R. 37, 43 (Bankr. W.D. Tex. 1998).Thus, prior to assumption, the non-debtor party to the contract is obligated to perform its contractual obligations, although the debtor is not similarly obligated to perform. *Id.*

3. **Assumption/Rejection, Timing, Twilight Period**

As a condition to assuming executory contracts and unexpired leases, bankruptcy courts require the purchaser to cure all defaults and provide adequate assurance of future performance. *See* § 365(b)(1)(A). A purchaser may be unable to assume contracts, if under applicable nonbankruptcy law, the nondebtor party to the agreement would be excused from accepting performance from an assignee. *See* § 365(c)(1)(A). The Bankruptcy Code permits the chapter 11 debtor-in-possession to assume or reject an executory contract at any time before confirmation of a plan of reorganization. *See* § 365(d)(2).

Any counterparty to an executory contract or lease with the debtor, however, may request that the court order the debtor to decide whether to assume or reject within a specified period of time. *See* § 365(d)(4). In *In re Panaco, Inc.*, the debtor was a non-operator of certain leases in the Gulf of Mexico. *Panaco, Inc.*, 2002 Bankr. LEXIS 2084, at *2. The operator and another non-operating interest owner requested that the bankruptcy court compel the debtor to assume or reject the JOA, within a specific timeframe. *Id.* In granting the motion, the court remarked that the debtor was not current on its post-petition obligations under the JOA and had made no accrual for plugging and abandonment costs. *Id.* at *9-10. The court found that preventing further delay with respect to assumption or rejection was in the best interest of the estate, creditors, and prospective purchasers. *Id.*

If a debtor-operator rejects a JOA in its bankruptcy case, non-operators receive a general unsecured claim for damages under the JOA. *See* §§ 365(g)(1) & 502(g). Rejection of the JOA does not automatically terminate the JOA. *Matter of Austin Development Company*, 19 F.3d 1077 (5th Cir. 1994) (noting that rejection does not equate to termination). Rejection of a JOA constitutes a breach of the JOA, which gives rise to a claim for damages. *Id.*

If a debtor wants to assume a JOA in its bankruptcy case, the debtor must cure any defaults under the JOA and provide adequate assurance of future performance. *See* § 365(b)(1). In connection with a sale of the debtor's assets, the debtor may seek to assume and assign the JOA to a third-party purchaser. In such a circumstance, counterparties to the JOA can demand adequate assurance that the third-party purchaser has the ability to perform under the JOA prior to the court's approval of the sale transaction. *See* § 365(b)(1)(C).

H. **Proofs of Claim**

A proof of claim is a written statement, usually filed by a creditor, describing the reason for and amount of debt allegedly owed by the debtor to the creditor. Official Form B10 is generally used in completing a proof of claim, and is available at the websites of most bankruptcy courts. It has also become commonplace for chapter 11 debtors to create their own proof of claim form.

I. **Who must file claims/review of schedules**

Section 501 and Rule 3001 generally govern who may file a proof of claim. Typically, creditors file proofs of claim against the debtor. Section 501 of the Bankruptcy Code, however, permits an avenue for the debtor or any entity liable to the creditor for the debtor owed by the debtor to file a proof of claim if the creditor fails to do so.

Although the Bankruptcy Rules prescribe specific deadlines for the filing of claims in

Chapter 7, 12, and 14, in a case under chapter 11, a proof of claim must be filed by the time set by the court. *See* Rule 3003(c)(3). The court may set the time for the filing of proofs of claim upon a debtor's motion or the motion of another party in interest. A notice of bar date will be sent to all creditors and parties in interest, setting forth the deadline by which a claim must be filed. The notice of bar date may instruct a creditor to send the proof of claim to a claims agent or require that the claim be filed electronically with the clerk's office of a particular court. Generally, filing proofs of claim by facsimile or electronic mail is not permitted.

To preserve a right to share in the distributions of the assets of the bankruptcy estate, a proof of claim must be filed. By filing a proof of claim, however, a creditor submits itself to the jurisdiction of the bankruptcy court. *In re Ha-Lo Industries,* 326 B.R. 116 (Bankr. N.D. Ill. 2005).

J. **Claim Objections**

If a creditor files a proof of claim, the claim is deemed allowed, unless a party in interest objects. "Deemed allowed" means that the holder of the claim will be able to "receive distribution from the debtor's assets in a case or under a plan." *See* § 502(a). To prevent the holder of the claim from receiving such distribution, a party in interest, typically the debtor or trustee, must file a written objection to the claim. *See* Fed. R. Bankr. P. 3007.Upon the filing of an objection, the claim is no longer "deemed allowed," but if the proof of claim was correctly filed in accordance with the relevant rules, it constitutes *prima facie* evidence of the claim's validity and dollar value. *Cavu/Rock Props. Project I, L.L.C. v. Gold Star Constr., Inc. (In re Cavu/Rock Props. Project I, L.L.C.),* 516 B.R. 414, 422 (Bankr. W.D. Tex. 2014) (citing Fed. R. Bank. P. 3001(f)).

If a party in interest objects to a proof of claim that is entitled to *prima facie* validity, the burden is on the objecting party to introduce evidence sufficient to rebut the presumption of validity. *In re Armstrong,* 320 B.R. 97, 102-4 (Bankr. N.D. Tex. 2005). To rebut the claim, the evidence the objecting party produces must be "at least equal in probative force to that offered by the proof of claim and which, if believed, would refute at least one of the allegations that is essential to the claim's legal sufficiency." *In re Rally Partners, L.P.,* 306 B.R. 165, 168 (Bankr. E.D. Tex. 2003) (citing *Lundell v. Anchor Const. Specialists, Inc. (In re Lundell),* 223 F.3d 1035, 1041 (9th Cir. 2000).Then, if the objecting party produces sufficient rebuttal evidence, the burden shifts to the claimant to prove its claim by a preponderance of the evidence. *Rally Partners, L.P.,* 306 B.R. at 168. For claims that are not entitled to *prima facie* validity, the claimant bears the burden to produce evidence to support the amount and validity of the claim. *In re Brunson,* 486 B.R. 759, 769 (Bankr. N.D. Tex. 2013).

K. **Other Basic Bankruptcy Issues**

L. **Avoidance Actions**

Chapter 5 of the Bankruptcy Code vests a bankruptcy trustee (or debtor-in-possession) with certain avoidance powers with respect to preferential transfers and fraudulent transfer actions. The term "transfer" is broadly defined by the Bankruptcy Code to mean, as applicable here, "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property." *See* § 101(54)(D).

With respect to preferences, § 547(b) of the Bankruptcy Code provides an independent power for a bankruptcy trustee to avoid payments or transfers made by a debtor on or within ninety (90) days of the date the debtor files bankruptcy. Section 547(b) of the Bankruptcy Code sets forth that a trustee can avoid "any transfer of an interest of the debtor in property":

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made:

i. on or within 90 days before the date of the filing of the petition; or

ii. between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

iii. that enables such creditor to receive more than such creditor would receive if—

a. the case were a case under chapter 7 of the Bankruptcy Code;

b. the transfer had not been made; and

c. such creditor received payment of such debt to the extent provided by the Bankruptcy Code.

Courts have held that having a right to payment from the debtor is sufficient to demonstrate that a transfer was made for or on account of an antecedent debt for § 547(b)(2). *See In re Intercontinental Polymers, Inc.*, 359 B.R. 868, 872 n.1 (Bankr. E.D. Tenn. 2005) (stating that the defendant was a creditor within the meaning of § 547(b) because the defendant had a right to payment from the debtor with respect to a debt that existed before the transfer, as demonstrated through unpaid invoices). In addition, courts agree that settlement agreements to resolve outstanding obligations can constitute an antecedent debt subject to preference avoidance. *Southmark Corp. v. Marley (In re Southmark Corp.)*, 62 F.3d 104 (5th Cir. 1995). An antecedent debt exists for purposes of § 547(b)(2) if a creditor has a claim against the debtor, even if the claim is unliquidated, unfixed, or contingent. *Warsco v. Preferred Tech. Group*, 258 F.3d 557 (7th Cir. 2001).

Section 547(b)(3) requires that the transfer be made while the debtor was insolvent, but § 547(f) provides for a presumption of insolvency that places the burden of proof of insolvency on the defendant, not the debtor/trustee. *See Gasmark Ltd. Liquidating Trust v. Louis Dreyfus Natural Gas Corp. (In re Gasmark Ltd.)*,158 F.3d 312 (5th Cir. 1998) (holding that "the party seeking to rebut the presumption [of § 547(f)] must introduce some evidence to show that the debtor was solvent at the time of the transfer; mere speculative evidence of solvency is not enough."). The final element, § 547(b)(5), is generally referred to as the "hypothetical Chapter 7 liquidation test" and examines whether the transfer enabled the creditor to receive more than it would in a liquidation. *See Gasmark*, 158 F.3d at 316. Courts have permitted trustees to satisfy their burden of proof on this issue through reference to a liquidation analysis providing that claims would not be paid in full in a hypothetical liquidation. *Id.*

Statutory defenses exist to shelter certain transfers from preference avoidance and are set forth in § 547(c) of the Bankruptcy Code. Courts have held that the defenses set forth in § 547(c) are the exclusive defenses available to a preference action. *See, e.g.*, *In re HDD Rotary Sales, LLC,* No. 12-03269, 2012 WL 6694072, *4 (Bankr. S.D. Tex. Dec. 20, 2012).

Among these statutory defenses, both the defense of contemporaneous exchange of new value and the ordinary course of business defense require subjective evidence of intent. Section 547(c)(1) shelters transfers from avoidance that are contemporaneous exchanges of new value. To establish the defense of §547(c)(1), a defendant must prove that the debtor and the defendant both intended for a transfer to be a *contemporaneous* exchange for new value and the transfer must have *in fact* been contemporaneous. *Creditor's Committee v. Spada (In re Spada),*903 F.2d 971, 975 (3d Cir. 1990). Section 547(c)(2)(A) shelters transfers from avoidance that constitute transfers made in the ordinary course of business; such defense is meant to protect "recurring, customary credit transactions that are incurred and paid . . . for the purpose of encouraging the continuation of business by suppliers with a person seeking a bankruptcy filing." *G. H. Leidenheimer Baking Co. v. Sharp (In re SGSM Acquisition Co., LLC),*439 F.3d 233, 240 (5th Cir. 2006). Section 547(c)(2)(B) shelters transfers from avoidance that are consistent with ordinary business terms of the relevant industry, and requires proof of relevant industry standards. *Gulf City Seafoods, Inc. v. Ludwig Shrimp Co., Inc. (In re Gulf City Seafoods, Inc.),* 296 F.3d 363, 368 (5th Cir. 2002).

In addition, §547(c)(3) provides a defense based on the creation of a purchase money security interest; under the facts, no such security interest is contemplated. Similarly, § 547(c)(5) provides a defense based on the creation of a perfected security interest in inventory or a receivable; under the facts no such security interest is contemplated. Finally, §547(c)(4) provides a defense based on the provision by the defendant of new value to or for the benefit of the debtor that is (a) not secured by an otherwise avoidable security interest and (b) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. This defense, known as the "new value defense" protects transfers that constitute the extension of "fresh credit" to the debtor by the defendant. Courts have held that forbearance by a creditor of exercising rights against the debtor does not constitute the provision of new value sufficient for § 547(c)(4). *Charisma Investment Co. v. Airport Systems Inc. (In re Jet Florida System Inc.)*, 841 F.2d 1082 (11th Cir. 1988).

Notably, for purposes of § 547(b), the Bankruptcy Code defines "new value" as "money or money's worth in goods, services, or new credit." *See* § 547(a)(2). This definition of new value applies both to the aforementioned defenses of subsequent new value in § 547(a)(4) and contemporaneous exchange of new value in § 547(c)(1). Although both § 547(a)(2) and § 547(a)(4) concern the provision of new value to a debtor, differences exist, including most importantly, § 547(a)(2)'s requirement that the provision of new value be a contemporaneous exchange with the alleged preferential transfer and § 547(c)(4)'s requirement that the new value be subsequent to an alleged preferential transfer.

Section 548 of the Bankruptcy Code enables a bankruptcy trustee to avoid fraudulent transfers, including both actually fraudulent transfers and constructively fraudulent transfers. Under § 548(a)(1)(A), the trustee may avoid a transfer that was made with the *actual intent* to "hinder, delay, or defraud" a creditor. Under §548(a)(1)(B), the trustee may avoid a *constructively fraudulent* transfer made for "less than a reasonably equivalent value." Section 548(a)(1) provides as follows:

> The <u>trustee may avoid any transfer</u> (including any transfer to or for the benefit of an insider under an employment contract) <u>of an interest of the debtor in property</u>, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor that was made or incurred on or <u>within 2 years</u> before the date of the filing of the petition, if the debtor voluntarily or involuntarily –
>
> (A) made such transfer or incurred such obligation with <u>actual intent to hinder, delay, or defraud</u> any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (B) (i) <u>received less than a reasonably equivalent value in exchange</u> for such transfer or obligation; <u>and</u> (ii) (I) <u>was insolvent on the date that such transfer</u> was made or such obligation was incurred, or <u>became insolvent as a result of such transfer</u> or obligation; (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under any employment contract and not in the ordinary course of business.

(emphasis added). Thus, a necessary issue in any constructively fraudulent transfer is whether the debtor received less than reasonably equivalent value. Notably, § 548(d)(2)(A) provides that "value" means "property, or satisfaction or securing of a present or antecedent debt of the debtor."

Courts have emphasized that the concept of "value" includes "any benefit" that inures to the debtor, either direct or indirect. *See Pension Transfer Corp. v. Beneficiaries Under the Third Amendment to Fruehauf Trailer Corp. Retirement Plan No. 003 (In re Fruehauf Trailer Corp.),* 444 F.3d 203, 212 (3d Cir. 2006). *See also, Official Comm. of Unsecured Creditors v. Hancock Park Capital II, L.P. (In re Fitness Holdings International, Inc.),* 714 F.3d 1141 (9th Cir. 2013) (noting that § 548(d)(2)(A) provides a definition of "value" to include "antecedent debt," and that "debt" is defined by § 101(12) as "liability on a claim," with "claim" in turn defined by § 101(5)(A) as "right to payment," which would include any right recognized as such under state law).

In taking such an approach, courts have stressed that "[a] determination of whether value was given under § 548 should focus on the value of the goods and services provided rather than on the impact the goods and services had on the bankrupt enterprise." *Orlick v. Kozyak (In re Financial Federated Title & Trust, Inc.),* 309 F.3d 1325, 1332 (11th Cir. 2002). The Bankruptcy Code does not define reasonably equivalent value. *In re Lindell,* 334 B.R. 249, 255 (Bankr. D. Minn. 2005). A determination of value thus necessarily is factually intensive and dependent upon the circumstances of each case, not a mathematical formula. *See Barber v. Golden Seed Co., Inc.,* 129 F.3d 382, 387 (7th Cir. 1997). Value includes the exchange of something for the purpose of reducing an obligation or debt already incurred by the debtor and outstanding. *Freeland v. Enodis Corp.,* 540 F.3d 721, 735 (7th Cir. 2008); *Official Comm. of Unsecured Creditors of Propex Inc. v. BNP Paribas (In re Propex Inc.),* 415 B.R. 321, 324 (Bankr. E.D. Tenn. 2009).

Importantly, property is valued as of the date of the transfer at issue for purposes of § 548. *Jimmy Swaggert Ministries v. Hayes (In re Hanover Corp.),* 310 F.3d 796, 802-03 (5th Cir. 2002). The term "fair market value" has been defined as "the price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arms' length transaction; the point at which supply and demand intersect." *Brandt v. Charter Airlines, LLC,* 511 B.R. 527, 535 (Bankr. N.D. Ill. 2014). Courts have approached the determination of whether reasonably equivalent value was given for an allegedly constructively fraudulent transfer in two parts, including by first examining whether the debtor received any value in the transaction and then next examining whether the value received was "reasonably equivalent" to what the debtor transferred. *Pension Transfer Corp.,* 444 F.3d 212-214; *Sender v. Buchanan (In re Hedged-Investment Assocs., Inc.),* 84 F.3d 1286, 1289 (10th Cir. 1996). Courts are afforded wide discretion in determining whether the value received was the reasonable equivalent of what the debtor gave up. *See, e.g., Gugino v. Ortega (In re Pierce),*428 B.R. 524, 530-31 (Bankr. D. Idaho 2010).

Notably, if a particular transfer is made with respect to a forward contract or a swap agreement, certain safe harbor protections may be triggered to shelter payments from avoidance that constitute "margin payments" or "shelter payments." Among these is the "safe harbor" protection afforded by virtue of § 546(e) of the Bankruptcy Code. *Williams v. Morgan Stanley Capital Grp., Inc. (In re Olympic Natural Gas Co.),* 258 B.R. 161 (Bankr. S.D. Tex. 2001), *aff'd* 294 F.3d 737 (5th Cir. 2002). Section 546(e) prevents a trustee or debtor from recovering and avoiding preferential or constructively fraudulent transfers under §§ 544, 547, and 548(a)(1)(B) of the Bankruptcy Code, by virtue of § 546(e) (although it does not protect payments from recovery of an actually fraudulent transfer under § 548(a)(1)(A)). *GPR Holdings, L.L.C. v. Duke Energy Trading and Mktg, L.L.C. (In re GPR Holdings),* 316 B.R. 477 (Bankr. N.D. Tex. 2004). This is because § 546(e) of the Bankruptcy Code provides as follows:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the <u>trustee may not avoid a transfer</u> that is a margin payment, as defined in section 101, 741, or 761 of this title, or <u>settlement payment</u>, as defined in section 101 or 741 of this title, <u>made by or to</u> (or for the benefit of) a commodity broker, <u>forward contract merchant</u>, stockbroker, financial

> institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, <u>in connection with</u> a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or <u>forward contract,</u> that is made before the commencement of the case, except under § 548(b)(1)(A) of this title. (emphasis supplied).

Under the Bankruptcy Code, a "settlement payment" is defined as "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade." *See* 11 U.S.C. § 101(51)(A). In *Olympic Natural Gas Co.*, the Fifth Circuit decided that the monthly payments paid pursuant to the contract there to settle each month's trading constituted "settlement payments" under § 101(51A). *See Olympic Natural Gas Co,* 294 F.3d at 742. In reaching its conclusion, the court cited that the term "settlement payment" should be interpreted very broadly," thus rejecting the trustee's argument that in order to be exempt from avoidance, a settlement payment must be made on a financial derivative contract and be cleared through a centralized system. *Id.; GPR Holdings, L.L.C. v. Duke Energy Trading and Mktg, L.L.C. (In re GPR Holdings),* 316 B.R. 477 (Bankr. N.D. Tex. 2004) (observing that a "settlement payment' is broadly defined to include any payment commonly used in the forward contract trade.).

A margin payment is defined by the Bankruptcy Code, for the purposes of forward contracts, as a "payment or deposit of cash, a security or other property, that is commonly known in the forward contract trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, or variation payments." Courts have construed the term "margin payments" broadly in the context of § 546(e). *Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846, 848 (10th Cir. 1990). Courts have held that the term "margin payment" includes any payment by a debtor to reduce a deficiency in a debtor's margin account. *Id.*

i. **Assets Sales**

Asset sales in bankruptcy occur in two main ways, either through a proposed plan of reorganization or under section 363 of the Bankruptcy Code. Section 363 of the Bankruptcy Code governs the sales of a debtor's assets outside the ordinary course of business. In determining whether a particular sale is outside the ordinary course of business, courts utilize two tests, the "horizontal test" and the "vertical test." *In re Crystal Apparel Inc.*, 207 B.R. 406, 409 (Bankr. S.D.N.Y. 1997). Under the "horizontal test," the court examines whether the transaction in question is one that businesses similar to the debtor would generally engage in as a part of its daily operations. *Id.* Under the "vertical test," however, courts examine whether the transaction is typical of transactions that the particular debtor engaged in prior to the petition date. *Id.*

Section 363 sales have become commonplace for debtors in chapter 11 proceedings for a debtor to sell substantially all of its assets. Section 363 sales can typically be completed rather quickly in a bankruptcy proceeding, and sometimes are put in place in the first days of a bankruptcy case. *See In Lehman Bros Holdings*, 445 B.R. 143, 148-49 (Bankr. S.D.N.Y. 2011) (commenting on expeditious nature of debtors' sale of assets under section 363 within first days of initial filing). Section 363(f) allows a debtor to sell its assets "free and clear" of existing liens, interest, and encumbrances. In addition, absent a stay pending appeal, section 363(m) effectively moots the ability of a party to appeal a sale, meaning that a section 363 sale has finality to it that may be appealing to potential purchasers of assets. Typically, debtors will also use a section 363 sale as an opportunity to assign unexpired leases and executory contracts to the purchaser.

While not all cases have a "stalking horse" bidder, the initial step for the debtor is to try and identify a "stalking horse" bidder to be the initial bidder who agrees to take the lead in establishing a floor price for the assets. The stalking horse also negotiates an asset purchase agreement, which will be shopped around to other potential bidders. If the stalking horse bidder does not turn out to be the successful bidder, it typically will be entitled to a "break-up fee," which is payment of a specific amount. Courts apply the business judgment rule to determine whether a proposed break-up fee should be approved. *In re Integrated Resources Inc.*, 147 B.R. 650 (S.D.N.Y. 1992); *In re Reliant Energy Channelview LP*, 594 F.3d 200, 206 (3d Cir. 2010). Generally, bankruptcy courts approve break-up fees that fall within a range of between 2% and 4% of the proposed purchase price. *Id.*

When a stalking horse has been identified and the bankruptcy court has approved the bidding procedures, qualified bidders are then able to submit bids for the assets. Although the bidding procedures will provide specific definitions, qualified bidders are those who typically submit an asset purchase agreement, generally in a marked-up form against the version of the stalking horse purchaser. A qualified bidder will typically be required to submit a minimum amount of earnest money plus admissible evidence of sufficient financing or wherewithal to close the transaction.

An auction is held in the event more than one qualifying bids are received. The debtor will select what it considers to be the "highest and best offer." The bankruptcy court will then hold a final hearing to approve the sale to the winning bidder.

M. **Plan & Disclosure Statements**

1. **Disclosure Statements**

The disclosure statement in a chapter 11 case is designed to give creditors and other parties in interest (including contractual counterparties) adequate information of the nature and history of the debtor, as well as the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor, that would enable a hypothetical investor to make an informed judgment about the plan. *See* § 1125(a).

A disclosure statement typically contains a summary of the debtor's proposed plan of reorganization and a liquidation analysis. It also typically will contain a description of claims against the debtor as well as a description of how the debtor intends to treat claims in the proposed plan. A disclosure statement may also set forth a comparison of the proposed plan with a hypothetical chapter 7 liquidation. A disclosure statement may also contain other information, including information about ongoing litigation concerning the debtor, to enable creditors to make an informed judgment about the plan.

The bankruptcy court may approve a debtor's disclosure statement as containing adequate information. After a court has ruled that a debtor's disclosure statement contains adequate information as required under the Bankruptcy Code, the debtor will be authorized to solicit votes for acceptance of a plan.

2. **Plans**

The debtor has a 120-day period from the petition date during which it has the exclusive right to file a plan. *See* § 1121(b). The bankruptcy court may extend or reduce such period, but the exclusivity period may not extend longer than 18 months. *See* § 1121(d). After the exclusivity period is ended (either by the expiration of time or a court order), a creditor may file a competing plan.

The contents of a chapter 11 plan include a classification of claims and a specification as to the treatment of claims under the plan. *See* § 1123. A debtor may propose to "impair" a claim, meaning that the creditor's contractual rights are to be modified or the holder of the claim will be paid less than the full value of claims under the plan or the creditor's claim will not be paid in full in cash on the effective date. *See* § 1126. Creditors whose claims are "impaired" vote on the plan by submitting a ballot. A court order will typically set forth a voting deadline by which ballots must be submitted. The court will then conduct a confirmation hearing to determine whether the plan should be confirmed. *See* § 1128.

Section 1123(a) of the Bankruptcy Code enumerates the mandatory provisions of a chapter 11 plan. Section 1123(b), in turn, sets forth permissible provisions. Section 1123(a)(1) provides that a chapter 11 plan must designate classes of claims and interest for treatment under the proposed plan. Typically, a plan will classify claim holders as secured creditors, unsecured creditors entitled to priority payment, general unsecured creditors, and equity security holders.

An entire class of claims is "deemed" to accept a plan if the plan is accepted by creditors that hold at least two thirds in amount and more than one-half in number of the allowed claims in the class. If a plan contains impaired classes of claims, the bankruptcy court cannot confirm the plan unless the plan has been accepted by at least one class of non-insiders that hold impaired claims. Holders of unimpaired claims are deemed to have accepted the plan. *See* § 1126(f).

Any party in interest may file an objection to confirmation of a plan. At the hearing on confirmation of the plan, the bankruptcy court determines whether the proposed plan has been proposed in good faith and according to law. *See* Rule 3020(b)(2). The proponent of the plan must also prove that the plan meets the requirements for confirmation in § 1129, even if no objection was filed. *See In re Patriot Place, Ltd.*, 486 B.R. 773 (Bankr. W.D. Tex. 2013). To enter a confirmation order on the plan, the bankruptcy court must find that the plan is feasible, proposed in good faith, and the plan and the proponent of the plan have complied with the bankruptcy code. *Id.*

Section 1141 of the Bankruptcy Code provides that confirmation of a plan discharges the debtor from any debt that arose prior to confirmation. *Louisiana Dept. of Environmental Quality v. Crystal Oil Co. (In re Crystal oil Co.)*, 158 F.3d 291 (5th Cir. 1998) (holding that a debtor's environmental liability was discharged for failure to file a claim and a late claim would not be allowed); *Sequa Corp. v. Christopher (In re Christopher)*, 28 F.3d 512 (5th Cir. 1994)(holding that a post-petition claim was discharged based on the creditor's actual knowledge of debtor's bankruptcy despite lack of notice to creditor). Finally, once the bankruptcy court confirms a plan, the confirmation order may only be revoked on request by a party in interest made at any time before 180 days from the date of entry of the order, if and only if the order was procured by fraud. *See* § 1144.