

IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE: §
§
EP ENERGY CORPORATION, § Case No. 19-35654 (MI)
et al. §
§ Chapter 11
Debtor. §
§

**UNITED STATES’ LIMITED OBJECTION AND RESERVATION OF RIGHTS
WITH RESPECT TO: (1) MOTION OF DEBTORS FOR FINAL ORDER
(I) AUTHORIZING USE OF CASH COLLATERAL; (II) AUTHORIZING DEBTORS
TO OBTAIN SENIOR SECURED, SUPERPRIORITY, POSTPETITION FINANCING;
(III) GRANTING LIENS AND SUPER-PRIORITY CLAIMS; (IV) GRANTING
ADEQUATE PROTECTION TO PREPETITION SECURED PARTIES;
(V) AUTHORIZING DEBTORS TO ENTER INTO AND PERFORM UNDER EXIT
FINANCING AGREEMENTS; AND (VI) GRANTING RELATED RELIEF (ECF
NO.182); AND (II) EMERGENCY MOTION OF DEBTORS: (I) AUTHORIZING
DEBTORS’ USE OF CASH COLLATERAL; (II) GRANTING ADEQUATE
PROTECTION TO PREPETITION SECURED PARTIES; (III) MODIFYING THE
AUTOMATIC STAY; (IV) SCHEDULING A FINAL HEARING;
AND (V) SEEKING RELATED RELIEF (ECF NO. 5)**

[Relates to Docket Nos. 5, 65, 182]

The United States, on behalf of the United States Department of the Interior (“Interior”), and its bureaus and sub-agencies, the Bureau of Land Management (“BLM”), the Bureau of Ocean Energy Management (“BOEM”), the Bureau of Safety and Environmental Enforcement (“BSEE”), the Bureau of Indian Affairs (“BIA”) and the Office of Natural Resources Revenue (“ONRR”), hereby files this Limited Objection and Reservation of Rights (the “Limited Objection”) to the *Motion of Debtors for Final Order (I) Authorizing Use of Cash Collateral; (II) Authorizing Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing; (III) Granting Liens and Super-Priority Claims; (IV) Granting Adequate Protection to Prepetition Secured Parties; (V) Authorizing Debtors to Enter Into and Perform Under Exit*

Financing Agreements; and (VI) Granting Related Relief (ECF No. 182) (the “DIP Motion”) and *Emergency Motion of Debtors: (I) Authorizing Debtors’ Use of Cash Collateral; (II) Granting Adequate Protection to Prepetition Secured Parties; (III) Modifying The Automatic Stay; (IV) Scheduling A Final Hearing; and (V) Seeking Related Relief* (ECF No. 5) (the “Interim Cash Collateral Motion”); together with the DIP Motion, the “Motions”), and in support of its Limited Objection, respectfully states as follows:

BACKGROUND

1. The above-captioned debtors (the “Debtors”) are an oil and gas exploration and production company holding interests in various federal oil and gas leases and rights-of-way (each, a “ROW”; and collectively with the Debtors’ federal oil and gas leases, the “Leases”) covering onshore federal and Indian lands, as well as the Outer Continental Shelf (the “OCS”). The Debtors also serve as the operator for several Leases both on federal lands onshore and on the OCS.

2. On October 3, 2019 (the “Petition Date”), each of the Debtors filed a voluntary petition for relief under chapter 11, title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the “Bankruptcy Code”). The Debtors’ chapter 11 cases are being jointly administered.

3. On October 4, 2019, the Debtors filed the Interim Cash Collateral Motion and the Declaration of David Rush in Support of Debtors’ Chapter 11 Petitions and Related Requests for Relief (ECF No. 16). On the same date, this Court entered an Order (the “Interim Cash Collateral Order”) approving the use of interim cash collateral in accordance with a 13 week cash collateral budget annexed to the Interim Cash Collateral Order as Exhibit A until the occurrence of a Cash Collateral Event of Default (as defined in the Interim Cash Collateral

Order). The final hearing for the Interim Cash Collateral Motion was set for November 7, 2019 and then continued to November 20, 2019.

4. On October 18, 2019, the Debtors filed the DIP Motion and the Declaration of Avinash D'Souza (ECF No. 186) in support thereof.

5. Based on Interior's records, performance of decommissioning is currently overdue on at least 12 offshore OCS Leases (00251, 00253, 00254, G00978, G01777, G04379, G04586, G04767, G12027, G12427, G13628 and G13925) (collectively, the "Overdue OCS Leases"). BLM and BIA are currently still assessing the status of reclamation and plugging and abandonment obligations across the Debtors' onshore federal and Indian leases.

LIMITED OBJECTION

6. The Outer Continental Shelf Lands Act, 43 U.S.C. §§1331-56 ("OCSLA"), gives the United States jurisdiction over the mineral resources found in submerged lands on the OCS. 43 U.S.C. §1332. The Secretary of the Interior (the "Secretary") controls the disposition of mineral resources on the OCS through oil and gas leases. 43 U.S.C. §§ 1332(1) and 1337(a)(1). Interior is also charged with discretionary authority over the management of oil and gas rights for onshore federal lands pursuant to the Mineral Leasing Act of 1920, 30 U.S.C. § 181 *et seq.* ("MLA") and the Mineral Leasing Act for Acquired Lands, 30 U.S.C. § 351 *et seq.* ("MLAAL"). Finally, the Indian Mineral Leasing Act ("IMLA"), 25 U.S.C. §§396a-g, authorizes the Secretary to approve and manage leases and permits for the development of Indian tribal oil and gas resources.

7. Regardless of its bankruptcy, the Debtor is required to comply with all applicable federal laws. *In re Amer. Coastal Energy Inc.*, 399 B.R. 805, 810 (Bankr. S.D. Tex. 2009) ("A bankruptcy court is not a grant of immunity. Bankrupt debtors are no different from any citizen

in that they must comply with state and federal laws.”); *see also*, *Norris Square Civic Ass’n v. St. Mary Hosp.*, 86 B.R. 393, 398 (Bankr. E.D. Pa. 1988) (the debtor must apply with all applicable federal, state and local laws in conducting its business pursuant to 28 U.S.C. § 959(b)).

8. 28 U.S.C. § 959(b) provides, in relevant part that:

a trustee, receiver or manager appointed in any case pending in any court of the United States, including a *debtor in possession*, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959(b) (emphasis added).

9. The Debtors must conform with all environmental and other applicable laws in managing or operating their business during these chapter 11 cases, which obligation has been recognized explicitly by both the Fifth Circuit and this Court to include properly decommissioning, plugging and abandoning and/or performing reclamation on oil and gas wells in which the Debtor has an interest, including the continued monitoring and maintenance of all facilities until they are fully decommissioned or plugged and abandoned. *See* 28 U.S.C. § 959(b); *see also*, *Midlantic Nat’l Bank v. N.J. Dept. of Env’tl Prot.*, 474 U.S. 494, 502-507 (1986) (finding that 28 U.S.C. § 959(b) provides evidence that Congress did not intend the Bankruptcy Code to pre-empt environmental laws that are reasonably designed to protect the public health or safety from identified hazards); *Texas v. Lowe (Matter of H.L.S. Energy Co.)*, 151 F.3d 434, 438 (5th Cir. 1998) (finding that a combination of Texas and federal law, including 28 U.S.C. §959(b), placed an inescapable obligation on the trustee to comply with environmental obligations that arose during the chapter 11 proceedings); *Amer. Coastal*, 399 B.R. at 807 (holding that 28 U.S.C. § 959 clearly require a trustee to manage the property in its

possession in accordance with applicable law, which includes a continuing duty to plug wells under environmental laws); *see also*, *In the Matter of Chester B. Steenes*, No. 17-3630, 2019 WL 6001584, at *2-*3 (7th Cir. Nov. 12, 2019) (a debtor is responsible for all costs incident to operating an estate and such costs, as well as penalties and fines for failing to comply, constitute administrative expenses) .

10. It is of vital importance to Interior, as the environmental steward of the OCS and federal onshore and Indian lands, to ensure that the Debtors comply with decommissioning, plugging and abandonment and/or reclamation obligations under the terms of their Leases, OCSLA, MLA, MLAAL, IMLA and applicable federal regulations, including the retirement of inactive wells, all monitoring and maintenance obligations and the submission of financial assurance securing the Debtors' P&A Obligations. *See* 43 U.S.C. §1332 (stating as policy of the United States that (1) the OCS be developed "subject to environmental safeguards" and (2) operations be conducted in a safe manner to prevent or minimize the likelihood of occurrences that may cause damage to the "environment or to property, or endanger life and health."); 25 C.F.R. §211.1(a) (IMLA's implementing regulations seek to ensure that Indian mineral owners' resources are developed in a manner that, among other things, "minimizes the adverse environmental impacts . . . resulting from such development."); 43 C.F.R. §3162.5 (MLA and MLAAL's implementing regulations seek to ensure operations are conducted "in a manner which protects the mineral resources, and environmental quality."); *see also*, 30 U.S.C. 226(g) (the Secretary of the Interior will "establish such standards as may be necessary to ensure that an adequate bond, surety, or other financial arrangement will be established prior to the commencement of surface-disturbing activities on any lease, to ensure the complete and timely

restoration of any lands or surface waters adversely affected by lease operations after the abandonment or cessation of oil and gas operations on the lease.”)

11. Decommissioning obligations, including the posting of financial assurance on leases to ensure proper decommissioning, take on particular importance on the OCS because idle infrastructure poses a potential threat to the OCS environment and may harm navigation safety. Among other things, idle infrastructure has the potential of breaking free from its moorings in a major storm and poses a particular threat to vessels in the area.

12. In an effort to address these potential harms, OCSLA and the regulations enacted pursuant thereto, notices to lessees, the terms of the Leases and other applicable law require the Debtors to, among other things: (i) permanently plug all wells; (ii) remove all platforms and other facilities; (iii) decommission all pipelines; and (iv) clear the seafloor of all obstructions created by the lease and pipeline right-of-way operations. 30 C.F.R. § 250.1703. In the onshore context, operators must permanently plug all wells with respect to a lease when it stops producing oil or gas. *See* 43 C.F.R. §3162.3-4 (onshore wells) and 43 C.F.R. § 3102.5-1 (in order to qualify as a lessee of an onshore lease, compliance with plugging and abandonment requirements is mandatory). In the Indian context, the lessee must securely plug all wells and effectively shut off all water from the oil or gas-bearing strata before abandoning them. *See* 25 C.F.R. § 211.47(e) and 43 C.F.R. §3162.3-4, *supra* (applicable to Indian leases through 25 C.F.R. § 211.4). The decommissioning, plugging and abandonment and/or reclamation obligations, as applicable, on federal onshore or Indian lands, or offshore on the OCS shall be referred to herein, collectively, as the “P&A Obligations.”

13. Offshore P&A Obligations arise when a well is drilled, a platform or other facility is installed or an obstruction is created, 30 C.F.R. § 250.1702, and onshore P&A Obligations

arise for the lessee and the operating rights owner arise when these entities commence drilling, installing or using onshore federal facilities, whether it is on federal or Indian land, 43 C.F.R. § 3162.3-1 and 43 C.F.R. § 3162.3-4. Applicable regulations require the Debtor to permanently plug all offshore wells and remove all offshore platforms and other offshore facilities within one year after lease termination. 30 C.F.R. §§ 250.1006, 250.1710 and 250.1725. Lessees and interest holders of federal onshore and Indian leases must permanently plug all wells with respect to an onshore lease when the well is no longer capable of production. *See* 43 C.F.R. §3162.3-4; *see also*, 30 U.S.C. 226(g).

14. Applicable Laws also require the Debtor to satisfy various monitoring and maintenance obligations (the “Monitoring and Maintenance Obligations”) including, without limitation, with respect to offshore OCS leases (i) performing pollution inspections, and making any necessary maintenance or repairs associated therewith, in compliance with 30 C.F.R. §250.300 and 30 C.F.R. §250.301; (ii) monitoring casing pressure for wells in compliance with 30 C.F.R. §§ 250.518, 250.519 and 250.520; (iii) bringing navigational aids for fixed structures and vessels in compliance with 33 C.F.R. §143.15; (iv) maintaining either a boat landing or heliport in service in compliance with 30 C.F.R. 250.132 to properly perform pollution inspections and maintenance or repairs and allow BSEE to safely conduct any inspections; (v) demonstrating oil spill financial responsibility (“OSFR”)¹ to BOEM pursuant to The Oil

¹ The Oil Pollution Action of 1990, 33 U.S.C. § 2701 *et seq.* and its implementing regulations found in 30 C.F.R. Part 553 (the “OSFR Regulations”) require that a responsible party for a covered offshore facility (a “COF”) designate an applicant (a “Designated Applicant”) to demonstrate oil spill financial responsibility (“OSFR”) to BOEM. *See* 30 C.F.R. § 553.11. Demonstration of OSFR ensures that the Designated Applicant for a COF has the financial resources necessary to pay for cleanup and damages that can be caused by oil spill discharges. *See* 30 C.F.R. § 553.5. Continuous OSFR coverage must be maintained for all COFs. *See* 30 C.F.R. § 553.15. The amount of OSFR that must be demonstrated is set forth in the OSFR Regulations and varies based on the worst case oil spill discharge volume that can be expected. *See* 30 C.F.R. § 553.13. A Designated Applicant must demonstrate OSFR and may be a responsible party authorized under the OSFR Regulations and other applicable federal

Pollution Act of 1990, 33 U.S.C. § 2701 *et seq.* and its implementing regulations found in 30 C.F.R. Part 553; and (vi) maintenance of an approved SEMs program pursuant to 30 C.F.R. Part 250, Subpart S.² With respect to onshore leasing, BLM personnel may enter the leased lands to perform inspections to ensure compliance with the applicable provisions of law or regulations, lease terms, orders or directives. 43 C.F.R. §3161.3. For Indian leases, the Debtor must exercise diligence in drilling and operating wells on the leased lands while minerals production can be secured in paying quantities; protect the lease from drainage, including drilling of offset wells and/or payment of compensatory royalties, if required; carry on operations in a good and workmanlike manner in accordance with approved methods and practices; have due regard for the prevention of waste of oil, gas or other minerals, the entrance of water to other strata, to the destruction or injury of the oil or gas, other mineral deposits, or fresh water aquifers, the preservation and conservation of the property for future productive operations, and the health and safety of workmen and employees; not construct any well pad location within 200 feet of any structures or improvements without the Indian surface owner's written consent; carry out, at the Debtor's expense, all reasonable orders and requirements of the BLM relative to prevention of waste, including compliance with applicable BLM regulations; bury all pipelines crossing tillable lands below plow depth unless other arrangements are made with the Indian surface owner; and pay the Indian surface owner all damages, including damages to crops, buildings, and other

regulations. *See* 30 C.F.R. § 553.11. A Designated Applicant may demonstrate OSFR by various means provided for in the OSFR Regulations, including self-insurance, insurance, indemnification, surety bonds or alternative methods that may be approved by the Director of BOEM. *See* 30 C.F.R. § 553.20.

² The list of Monitoring and Maintenance Obligations set forth in this Limited Objection are not meant to be exhaustive and Interior expressly reserves the right to enforce any and all Monitoring and Maintenance Obligations whether described in this Limited Objection or not.

improvements of the Indian surface owner occasioned by the lessee's operations as determined by the BIA. *See* 25 C.F.R. §§ 211.4; 211.47(a)-(d) and (f)-(i); and 211.49.

15. Finally, Debtors must provide financial assurance to secure its P&A Obligations (the “Financial Assurance Obligations”). *See* 30 C.F.R. Part 556, Subpart 1 and BOEM NTL 2016-01, Notice to Lessees and Operators of Federal Oil and Gas and Sulfur Leases and Holders of Pipeline Right of Way and Right of Use and Easement Grants in the Outer Continental Shelf effective September 12, 2016 (the “2016 NTL”); *see also*, 43 C.F.R. § 3104.1(a) (with respect to federal onshore leases, the lessee, the operating rights owner or the operator must submit a personal or surety bond to BLM prior to the commencement of surface disturbance activities); For Indian leases, the lessee, permittee or prospective lessee acquiring a lease, or any interest therein, by assignment shall furnish with each lease, permit or assignment a surety bond or personal bond in an amount sufficient to ensure compliance with all of the terms and conditions of the lease(s), permit(s), or assignment(s) and the statutes and regulations applicable to the lease, permit, or assignment, and in a form specified by the regulations. 25 C.F.R. § 211.24.

16. Failure to meet P&A Obligations, Maintenance and Monitoring Obligations and Financial Assurance Obligations constitutes a violation of the terms of an OCS lease and regulatory requirements and avails Interior the remedies outlined in 43 U.S.C. § 1350, including injunctive relief and civil penalties. In the onshore context, whenever any person fails or refuses to comply with any regulations under 43 C.F.R. §3100, the terms of any lease or permit, or the requirements of any notice or order, Interior may assess penalties, suspend operations and initiate actions to cancel the lease. *See* 43 C.F.R. § 3163. Violation of the terms of an Indian lease or the relevant statutes or regulations may prompt the Secretary to serve a notice of non-compliance

on the lessee. 25 C.F.R. § 211.54. If the violation is not corrected, the Secretary may proceed to impose penalties or cancel the lease. 25 C.F.R. §§ 211.54 and 211.55.

17. Interior acknowledges that the Debtor needs access to appropriate funding to comply with its public health and safety and environmental obligations and to continue to perform, or contract with other third parties to perform, its regulatory and contractual P&A Obligations. Thus, Interior does not object outright to the Debtors obtaining access to cash collateral and necessary DIP financing. Interior, however, requests the entry of the protective Reservation of Rights language below to ensure that the Debtors will not be precluded, impeded or limited from complying with applicable laws and regulatory obligations including, without limitation, as described in this Limited Objection.

18. The United States (including any and all of its agencies) also seeks assurance that any setoff or recoupment rights that it may have will be preserved. The debtor takes property of the estate subject to the right of recoupment. *See Matter of Holford*, 896 F.2d 176, 179 (5th Cir. 1990) (with respect to amounts recouped “the debtor has no interest in the funds and, therefore, the stay has not been violated.”); *Matter of Kosadnar*, 157 F.3d 1011, 1016 (5th Cir. 1998) (same); *Matter of U.S. Abatement Corp.*, 79 F.3d 393, 398 (5th Cir. 1996) (same). Moreover, setoff satisfying the requirements of section 553 of the Bankruptcy Code is a defense to turnover under section 542 of the Bankruptcy Code. *See* 11 U.S.C. §§ 542 and 553 and *Braniff Airways Inc. v. Exxon Co., USA*, 814 F.2d 1030, 1037-40 (5th Cir. 1987).

RESERVATION OF RIGHTS

19. Interior requests the entry of the following proposed language in any DIP or cash collateral order to preserve Interior’s rights:

Notwithstanding any other provision of this Order, nothing in this Order or in any of its implementing documents including, without

limitation, the DIP Credit Agreement annexed to the Order, any Commitment/Fee Letter, any DIP financing or cash collateral budgets and/or in any other DIP Documents shall limit or affect, in any way, the rights of the Department of the Interior or the obligations of the Debtors with respect to the Debtors' decommissioning, plugging and abandonment and reclamation obligations, including monitoring and maintenance obligations and financial assurance obligations, associated with the Debtors' interests in each of its federal and Indian oil and gas leases, grants of right-of-way and rights-of-use and easements. All rights of the United States under 11 U.S.C. § 362(b)(4), 28 U.S.C. § 959(b) or any other applicable laws or regulations are expressly preserved. Nothing in this Order or in any of the DIP Documents shall affect, waive, impair, or limit any rights to setoff or recoupment that the United States (including any and all of its agencies) may have. To the extent that anything in this Order or in any of the DIP Documents conflicts with this paragraph, this paragraph shall expressly supersede and control.

(the "Reservation of Rights").

20. The United States respectfully reserves its rights to object to the Motions on the grounds set forth in this Limited Objection at the hearing on the Motion or on any further grounds to the extent that additional information is determined by the United States prior to hearing.

WHEREFORE, the United States respectfully requests that this Court enter an Order including the Reservation of Rights requested by the United States and granting such other and further relief as this Court deems just and proper.

Dated: Washington, DC
November 15, 2019

Respectfully submitted,

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ATTORNEYS FOR THE UNITED STATES

CERTIFICATE OF CONFERENCE

I hereby certify that on November 13, 2019, counsel for the United States conferred by e-mail with the Debtor's counsel requesting inclusion of the Reservation of Rights language in any proposed cash collateral and DIP order and further conferred with Debtors' counsel regarding same by telephone on November 14, 2019. As of the date of this Limited Objection, the Debtors have not yet agreed to include the Reservation of Rights language and the United States files this Limited Objection out of an abundance of caution in case no agreement can be reached.

/s/ Eunice R. Hudson
EUNICE R. HUDSON

CERTIFICATE OF SERVICE

I hereby certify that on November 15, 2019 a true and correct copy of the foregoing Limited Objection was duly served upon all parties requesting service via the Court's electronic case filing system (ECF).

/s/ Eunice R. Hudson
EUNICE R. HUDSON