Energy & Resources Notes

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Christina Sheehan and Frank Davis, co-editors

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No Mora Moratorium on Drilling

United States District Court Judge James Browning issued a lengthy opinion on January 19, 2015 invalidating Mora County's "Community Rights and Local Self-Government Ordinance", enacted by the County in 2013, that prohibited oil and gas development by corporations in the county. See *SWEPI, LP v. Mora County*, 2015 U.S. Dist. LEXIS 13496 (D.N.M. Jan. 19, 2015). The Community Environmental Legal Defense Fund (CELDF), a Pennsylvania nonprofit that advocates for community self-governance, developed the Ordinance. Under the Ordinance, it was declared unlawful for "any corporation to engage in the extraction of oil, natural gas, or other hydrocarbons within Mora County." Additionally, the Ordinance declared illegal the extraction of water from any surface or subsurface source within Mora County for use in oil and gas development by a corporation or its directors, officers, owners or managers. The Ordinance further outlawed the use of water for fracturing. Corporations which violated the Ordinance were deprived of the rights of "persons" afforded by the United States and New Mexico Constitutions, and were deemed to have forfeited their rights under the First and Fifth Amendment and the Commerce and Contract Clauses of the United States Constitution and corresponding sections of the New Mexico Constitution.

Initially, Judge Browning held that the provisions of the Ordinance which purported to strip corporations of their constitutional rights were preempted by federal law, rejecting Mora County's contention that county residents' right to self-government recognized by the Declaration of Independence and the Treaty of Guadalupe Hidalgo establish, or at least recognize, such rights. The court ruled that "corporations have constitutional rights that inferior law cannot infringe, regardless of the Defendants' interpretation of the Declaration of Independence and the Treaty of Guadalupe Hidalgo." 2015 U.S. Dist. LEXIS 13496, slip op. at 222.

Despite what most observers viewed as the obvious constitutional infirmity of the Ordinance, the Court gave equal consideration to every argument advanced in support of the Ordinance, ultimately ruling that the County's ban on oil and gas developed was preempted by State law, stating:

> By banning hydrocarbon exploration-and-extraction activities, the Ordinance is antagonistic to state law, because it prohibits activities that New Mexico state law permits. ***
>
> State law is not silent on the exploration and extraction of hydrocarbons. The State has created an extensive statutory and regulatory scheme to regulate oil-and-gas production. By extensively regulating oil-and-gas production in a manner that is intended to prevent waste, see N.M. Stat. Ann. § 70-2-2, the State has indicated that oil-and-gas extraction is permitted.... If a complete ban on all hydrocarbon extraction activities does not constitute a county ordinance that conflicts "with state law when state law . . . is of such a character that local prohibitions on those activities would be inconsistent with or antagonistic to that state law or policy," then no county ordinance will ever fall within this standard. Consequently, the Ordinance's hydrocarbon-extraction ban conflicts with state law.***
>
> Moreover, the Ordinance's ban conflicts with state law by creating waste and not recognizing correlative property rights, which the Oil and Gas Act prohibits.

2015 U.S. Dist. LEXIS 13496, slip op. 293-302. (citations omitted).

The United State District's Court's opinion leaves the door open for some local regulation of oil and gas development, based on the court's initial conclusion that under the Oil and Gas Act, the New Mexico Oil Conservation Division's (NMOCD) authority over oil and gas development was not exclusive. Applying an earlier New Mexico Court of Appeals decision interpreting the Mining Act, the court noted that the Oil and Gas Act did not address issues such as traffic, noise limitations near residential areas or potential nuisance

issues from sound, dust, or chemical run-off. According to the court's analysis, the absence of specific state regulation on these issues left room for concurrent regulation by Mora County. However, the opinion fails to consider that under its statutory charge to protect the environment, NMOCD has enacted special regulations for oil and gas development in Santa Fe and select areas of Otero and Doña Ana counties.

Where counties seek to regulate oil and gas development activities such as hydraulic fracturing based on a desire to protect groundwater resources, the argument for field preemption under the Oil and Gas Act is greater because in New Mexico "all water within the state, whether above or beneath the surface of the ground belongs to the state, which authorizes its use…" *State ex rel. Erickson v. McLean*, 1957--NMSC--012, ¶23, 62 N.M. 264, 271. The EPA has further delegated authority to the State of New Mexico to enforce most aspects of the federal Safe Drinking Water Act and Clean Water Act. The Oil Conservation Commission in turn is the state agency which has been granted authority to enforce the federal water pollution statutes under New Mexico's Water Quality Act. The Water Quality Act prohibits the Water Quality Control Commission from taking any action which would "interfere with the exclusive authority of the Oil Conservation Commission over all persons and things necessary to prevent water pollution as a result of oil or gas operations...." NMSA 1978, §74-6-12(G).

To remove any doubt concerning field preemption, a bill was under consideration by the Legislature in the 2015 legislative session, which would have recognized the exclusive authority of the New Mexico Oil Conservation Division to regulate oil and gas development. *See* NM House Bill 366.[1] This bill was passed by the House but failed in the Senate on March 13, 2015. The Mora County Commission, following Judge Browning's opinion, unanimously repealed the Ordinance on March 29, 2015. The Commission recognized Judge Browning's finding that the Ordinance was unconstitutional, and that it was not the correct way to limit oil and gas activities in the County.

For additional information, please contact Earl E. DeBrine.

[1] The bill would have modified the Oil and Gas Act by declaring that "the state has exclusive jurisdiction and authority over all matters relating to oil and gas conservation, extraction, production, processing, storage and transportation." The exclusive jurisdiction of the State would then be vested by HB 366 in the NMOCD and Oil and Gas Conservation Commission and would have specifically included "the siting of oil or gas wells and ancillary facilities, the drilling and completion of oil or gas operations as well as producing, processing, storage and transportation of oil or gas."

New Mexico Oil Conservation Commission Adopts New Produced Water Regulations

On March 12, 2015, the New Mexico Oil Conservation Commission formally approved a revision to the Commission's produced water regulations. The revised Rule repeals and replaces existing Rule 34, which regulates the disposition of produced water, and enacts a new rule regulating the reuse and recycling of produced water to reduce reliance on fresh water for well completions. The rule was approved by OCD Order Number 15239, and became effective March 31, 2015.

The revised rule tailors the definition of produced water to the statutory definition in the Oil and Gas Act, which grants the Commission authority to regulate the disposition of produced water. NMSA 1978, §70-2-12(B)(15). The new rule broadens the scope of the previous rule on permitting and disposal of produced water to now govern "the transportation, disposal, recycling, re-use or the direct surface or subsurface disposition by use of water produced or used in connection with the development or production of

oil or gas or both; in road construction or maintenance, or other construction; in the generation of electricity or in other industrial processes." 19.15.35.2 NMAC (March 31, 2015).

The new rule is intended to promote water conservation by encouraging the reuse and recycling of produced water through the regulation of facilities that store, treat and recycle water for use in drilling, completion, production or plugging oil and gas wells. The rule includes siting, design, construction, operation, closure and reclamation requirements for produced water containments based on standards for multi-well fluid management pits in Rule 17. Under the new rule, a permit is not required for the use or reuse of produced water for drilling, completion, production, secondary recovery, pressure maintenance or plugging of wells. A recycling containment facility must be registered with the New Mexico Oil Conservation Division and operated for up to five years, subject to annual renewal. Operators are also required to notify the surface owner when filing its registration form with the Division.

For additional information, please contact Christina C. Sheehan.

Environmental Groups Sue to Stop Fracking Near Chaco Canyon

The fight over fracturing ("fracking") associated with directional drilling plans for the Mancos Shale in northern New Mexico is heating up. On March 11, 2015, a coalition of environmental groups, including Diné Citizens Against Ruining Our Environment, San Juan Citizens Alliance, Wildearth Guardians, and Natural Resources Defense Council, filed suit against the U.S. Department of Interior and the Bureau of Land Management (BLM), alleging violations of the National Environmental Policy Act (NEPA) and National Historic Preservation Act (NHPA).

The Complaint arises from BLM's decisions to approve at least 130 applications for permit to drill (APD) in the Mancos Shale/Gallup formations. Although it is currently unclear where each of the associated wells is located, the environmental groups allege the wells are near Chaco Culture National Historic Park ("Chaco Canyon"). Chaco Canyon is a United Nations World Heritage Site, which contains monumental stone structures, cultural sites, and ceremonial roads that were constructed by ancestors of some of the Native American tribes in the region. The environmental coalition alleges that BLM has engaged in "an egregious pattern and practice of approving drilling permits into the Mancos Shale through piecemeal, boilerplate environmental assessments."[1] The coalition further alleges that fracking near Chaco Canyon threatens emission of hazardous air pollutants and the area's surface and groundwater supplies.[2]

The coalition seeks to enjoin BLM from approving any APDs that permit horizontal drilling or hydraulic fracturing in the Mancos Shale and any future drilling pursuant to APDs previously approved by BLM, pending full compliance with NEPA and NHPA. Previous efforts made by archeologists and environmentalists to set aside more than 1 million acres around Chaco Canyon as an area of critical environmental concern have failed.

For additional information, please contact Stuart R. Butzier.

[1] *Diné Citizens Against Ruining Our Environment v. Sally Jewell*, Case No. 1:15-cv-209 [Document 1], at p. 2, filed 03/11/15.

[2] *Id.* at 3.

BLM Publishes New Rule for Hydraulic Fracturing; Oil and Gas Groups Bring Challenge

On March 26, 2015, the Bureau of Land Management (BLM) published in the Federal Register its much anticipated new regulatory rule governing hydraulic fracturing (HF) operations conducted on Federal and Indian lands. 80 Fed. Reg. 16128-16222 (March 26, 2015). The rule culminates a public process resulting from controversial draft rulemakings published originally in May 2012 and again in May 2013 that drew well over a million public comment submissions.

According to BLM, the "increased complexity" of HF operations, when coupled with large-scale operations involving new horizontal drilling technology, warrants "additional regulatory effort and oversight." Citing "public concern about whether fracturing can lead to or cause the contamination of underground water sources, and whether the chemicals used in fracturing pose risks to human health," BLM adopted the rule in an attempt to "adequately address emerging technological developments and health and environmental protections," but stated it would evaluate the rulemaking seven years after the date of publication.

Immediately upon BLM's publication of the final draft of the rule, the Independent Petroleum Association of America (IPAA) and the Western Energy Alliance (WEA) brought a challenge to the agency action in the United States District Court for the District of Wyoming claiming the rule is "arbitrary and unnecessary" agency action that either "duplicate[s] state law" or "improperly curtail[s] the primary jurisdiction of state governments." The IPAA/WEA petition also asserts that BLM's rules are "a reaction to unsubstantiated concerns [lacking] factual, scientific or engineering evidence." *See Independent Petroleum Assoc. of America, et al. v. Jewell, et al.*, Civ. No. 15-CV-41-F. IPAA's press release issued the same day as the petition criticizes the new regulatory program as a redundant regime that merely adds to BLM's struggle to meet its already significant regulatory workload.

The Effect of BLM's New Rule:

In a nutshell, BLM's new rule establishes an oversight program designed to work in tandem with existing BLM programs for oversight and approvals of oil and gas drilling on federal and Indian lands. The rule requires operators on federal and Indian lands to make substantial public disclosures to BLM officials in advance of HF operations as well as after completion (including, among many other things, identifications of chemicals and sources of water to be used in the operations), to diligently assess the casing of wells and address inadequate casings before commencing operations, to monitor operations and carefully manage and handle HF flowback fluids, and to do extensive monitoring of HF operations, take corrective actions when needed, and provide extensive reports (utilizing the widely used FracFocus source) and certifications to BLM during and after the completion of HF operations.

In response to concerns raised by industry during the public comment periods, BLM's new rule includes narrowly circumscribed opportunities for operators to submit master HF plans for groups of wells (but each well still requires an individual approval and reporting), to employ a range of methods for determining casing adequacy, to meet a long list of criteria justifying the use of lined pits rather than the generally required above-ground tanks for fracturing and flowback fluids, and to seek protection of certain information as trade secrets so long as the operator can establish competitors could use the information, and that there is a likelihood of substantial competitive harm if the information is disclosed to the public. The rules also provide operators, as well as state and tribal authorities, certain opportunities to seek variances from the requirements of the rules, and purport to grant discretion

to BLM officials to decide when variances are warranted. Finally, BLM, in the comments accompanying the published rules, encourages coordination between federal, state and tribal regulators, but it remains to be seen how effectively that will occur given that BLM's rules differ in some respects from rules administered by state agencies on private, state *and federal* lands, and the variance opportunities for state and tribal authorities are narrowly limited.

Comprehensive Summary of BLM's New Rule:

BLM's new HF rule is adopted in the form of amendments to 43 CFR Subpart 3160 relating to onshore oil and gas operations generally, and Subpart 3162 containing requirements for operating rights owners and operators. A brief summary of specific parts of BLM's new HF rule follows:

Applicability. BLM's new rule applies to HF operations on federal or Indian lands. Pursuant to the terms of a table in amendments to Section 3162.3-3(a), all or portions of the new rule apply to any HF operations for which an application for permit to drill (APD) was either not applied for or not approved by BLM within 90 days from the March 26 publication date of the rule, or by June 24, 2015. All or portions of the rule also apply to new or renewed HF operations where authorized drilling operations were completed prior to the effective date of the rule.

Advance Approval Required. Advance approval may be sought for HF operations with an APD or a Sundry Notice and Report on Wells (Form 3160-5) as a notice of Intent (NOI). In order to be approved, all HF operations must meet the performance standard in Section 3162.5-2(d) relating to the isolation of usable waters to prevent contamination. Further, under Section 3162.3-3(e), BLM approval will not be provided until documentation of the adequacy of cementing is provided no less than 48 hours prior to commencement of proposed HF operations. The only narrow exception is that prior advance approval will not be required just for further well operations (such as redrilling, deepening, repairing casings, plugging back, etc., that may be in anticipation of separately approved HF operations), but only to the extent of "acidizing jobs or recompletion in the same interval," and subsequent reporting of those activities is required under Section 3162.3-2.

What Must Accompany An Approval Request. Section 3162.3-3(d) identifies the extensive information that must accompany an approval request for HF operations. The information includes, but is not limited to: specific information about the top and bottom depths of the formation into which HF fluids will be injected, the "confining zone(s)" that must be capable of preventing fluid movement into a "usable water zone," and the usable water zones themselves; known and suspected faults or fractures within one-half mile of the wellbore trajectory that may transect the confining zone; the source and location of water supply as well as access route to bring the water to the site; a design plan for the HF operation that includes the "estimated total volume of fluid" to be used and the "maximum anticipated surface pressure" that will be applied during the fracturing process; a map showing the trajectory of the wellbore, the estimated direction and length of fractures, the "true vertical depth" of the top and bottom of fractures, and the trajectory and depth of existing wellbores within one half of a mile of *any portion* of the wellbore into which HF fluids are to be injected; the depth of the perforations or open hole interval and distance between the fracture zone and the nearest usable water zone; and information about the estimated volume of fluid to be recovered and the proposed methods of handling recovered fluids between the commencement of HF operations and the separate approval of a plan for the disposal of produced fluid under BLM requirements. In addition, where approval is sought using a Sundry Notice, a surface use plan of operations and documentation demonstrating that casing and cement have isolated usable water zones. The

authorized BLM official also may request additional information beyond all of the above.

Monitoring and Verification of Cementing Operations. BLM's new rule, in Section 3162.3-3(e), contains detailed provisions designed to ensure the adequacy of casing and cementing operations. During cementing operations on any casing used to isolate usable waters, the operator must "monitor and record the flow rate, density and pump pressure" and then submit a report to BLM prior to commencing operations. For surface casing, the operator must observe cement returns and document any indications of inadequate cement (such as lost returns), and if there are such indications, the top of cement must be determined using a cement evaluation log (CEL), temperature log, "or other method or device approved in advance by BLM. For intermediate and production casing, if the casing is not cemented to the surface, the operator must run a CEL to determine that there is at least 200 feet of adequately bonded cement between the deepest usable water zone and the deeper HF zone. Any indications of inadequate cementing must be reported to BLM within 24 hours, and a remedial action plan must be submitted on Form 3160-5 and carried out such that verification and certification of adequate cementing can be established by a CEL or other method and submitted to BLM in a subsequent Form 3160-5 report due at least 72 hours before starting HF operations.

Mechanical Integrity Testing. Section 3162.3-3(f) sets out requirements for mechanical integrity testing of casing at not less than the maximum anticipated surface pressure, and the MIT test will only be considered to be successful if the pressure applied holds for 30 minutes with no more than a 10 percent pressure loss.

Monitoring and Recording During HF Operations. Section 3162.3-3(g) provides for continuous monitoring and recording of the "annulus" (the space around a pipe in a wellbore) pressure at the "braidenhead" (the flanged fitting allowing casing strings and sealing of the annulus). The record must be submitted as part of what must be reported on Form 3160-5 after HF operations (see below). If the annulus pressure increases by more than 500 psi compared to the pressure prior to stimulation, then HF operations must cease until corrective actions are successfully implemented sometime after BLM is notified within 24 hours of the incident.

Management of Recovered Fluids. BLM's new rule does not use the term "flowback fluids," which is often used to describe HF fluids that are returned to the surface after HF operations. Instead, it refers to "recovered fluids," and then treats them similarly to produced water on the theory that the two types of fluids contain similar handling and disposal challenges. Section 3162.3-3(h) requires that recovered fluids be stored in "rigid enclosed, covered, or netted and screened above-ground tanks not exceeding a 500 barrel capacity unless approved by BLM in advance. If using such a tank is "infeasible for environmental, public health or safety reasons," then an operator may attempt to satisfy an extensive list of minimum conditions that must exist before may approve of a request to use lined pits instead of tanks.

Post-HF Operations Reporting. Under Section 3162.3-3(i), within 30 days of the final stage of HF operations for each well, information for each well must be reported to BLM using FracFocus, another BLM-designated database, or in a Subsequent Report Sundry Notice on Form 3160-5. The information must include: (1) the true vertical depth of the well, the total water volume used and, importantly, a description of the base fluid and each additive in the HF fluid (including detailed information on chemicals and concentrations thereof in the fluids); (2) the actual sources of the water used; (3) maximum surface pressure and rate at the end of each HF stage and the "actual flush volume;" (4) the *actual, estimated or calculated* fracture length,

height and direction; (5) the actual measured depth of perforations or the open hole interval; (6) the total volume of fluid recovered; (7) the methods of handling, storing, reusing or disposing of recovered fluids, and the associated disposition percentages for the fluids; (8) a certification of compliance with the BLM rule and other applicable federal, state or tribal laws; and (9) the result of the MIT test performed on the well. The authorized BLM official may require further substantiation of the information.

Claiming Exemptions from Public Disclosure. Section 3162.3-3(j) establishes a process and standard for claiming that information to be reported to BLM under the new HF rule are exempt from public disclosure, and the standard is a high one. First, if the information is actually provided to BLM using FracFocus or another BLM-designated database, then any right to protect the information from public disclosure is deemed waived. Second, to successfully protect any information withheld from such reporting, one or more affidavits of the operator (and the owner of the information, if different) must identify a statute or regulation that would prohibit BLM from disclosing the information, make several affirmations that, for example, the information has been withheld, is not publically available, is not required to be made public, and could not be reverse engineered using publically available information. Third, the affidavit(s) also must affirm that the owner of the information is in actual competition with identified competitors that could use the information to cause the owner of the information "substantial competitive harm," and demonstrate a factual basis for concluding that the release of the information "would likely cause substantial competitive harm." BLM may require that the information sought to be protected be provided during consideration of the claim, and if BLM decides it should be disclosed, it may disclose it after 10 business days from notice of the decision. Moreover, even where information about chemicals is withheld, the HF operator still must supply the generic name of the chemical that is not less specific than the generic chemical name that must be provided to the Environmental Protection Agency. Records of information withheld must be kept for 6 years after HF operations on Indian lands, and for 7 years after HF operations on federal lands.

Variance Opportunity for Operators, States and Tribes. It should be noted that both individual operators as well as States and Tribes, as well as BLM itself, are provided with opportunities to seek variances from the new rule under Section 3162.3-3(k). The rule provides that the granting of a variance is "entirely within BLM's discretion" and "is not subject to administrative appeals either to the State Director (for an individual variance) or under 43 CFR part 4." States and tribes may seek a variance from the State Director of BLM, and the opportunity is part of BLM's professed attempt to encourage cooperation where possible between BLM and its State and tribal counterparts in the regulation of HF operations. A variance, or a variance with conditions, may be granted "only if BLM determines that the proposed alternative meets or exceeds the objectives of the regulation for which the variance is being requested. Thus, for example, to the extent that a State or tribe might apply less onerous requirements on an operator than BLM now does in order to allow the use of lined pits rather than tanks for storing recovered fluids, it would appear that the opportunity to obtain a variance to allow more broadly for use of lined pits may be limited or non-existent.

Newly Defined Terms. Terms newly defined by amendments to the general onshore oil and gas operations rules in Subpart 3160 include:

- *Annulus* (essentially defined as the space around a pipe in a wellbore)
- *Braidenhead* (flanged fitting allowing casing strings and sealing of the annulus)
- *Cement evaluation log (CEL)* (a class of tools used to verify annular cementing)

- *Confining zone* (geologic features that would keep HF fluids from usable waters)
- *Hydraulic fracturing* (use of fluids under pressure to increase permeability)
- *Hydraulic fracturing fluid* (HF liquids or gas and associated solids and chemicals)
- *Isolating* (cementing to protect usable water and mineral resources)
- *Master hydraulic fracturing plan* (for wells with very similar characteristics)
- *Proppant* (granulars carried in HF fluids to keep cracks open post-fluids removal)
- *Usable water* (lists recognized categories of waters with 10,000 ppm or less TDS)

What's Next? Litigation challenges will proceed. In the meantime, operators will be faced with daunting challenges complying with the new regulations, and BLM offices, already struggling to manage existing paperwork, will have much more on their plates.

For additional information, please contact Stuart R. Butzier.

Office of Natural Resources Revenue Releases Proposed Federal Oil & Gas and Federal & Indian Coal Valuation Reform

On January 6, 2015, the Department of the Interior (DOI) through the Office of Natural Resources Revenue (ONRR) announced a proposed rulemaking for royalty valuations on Federal oil and gas leases and Federal and Indian coal leases. *See* 80 Fed. Reg. 608, *available at* http://www.onrr.gov. Comments pertaining to the proposed rule must be submitted to ONRR on or before May 8, 2015. Preceding the proposed rule, ONRR published Advanced Notices of Proposed Rulemaking in 2011 (ANPR) and conducted a series of public workshops concerning the valuation of oil, gas and coal royalties. Comments on the ANPR and workshops focused heavily on the utilization of index prices and on transportation and processing allowances. However, important changes proposed in the rule only tangentially relate to these topics and were not covered in the ANPRs or the ONRR workshops.

Creation of Discretionary Default Royalty Values and Allowances

One of the most notable changes proposed by ONRR is the creation of a "default provision" which would allow ONRR to "exercise considerable discretion" to establish a royalty valuation when "(1) a contract does not reflect total consideration, (2) the gross proceeds accruing to you or your affiliate under a contract do not reflect reasonable consideration *due to misconduct* or breach of the duty to market for the mutual benefit of the lessee and the lessor, or (3) it cannot ascertain the correct value of production because of a variety of factors, including but not limited to, a lessee's failure to provide documents." 80 Fed. Reg. 609-610 (emphasis added). The proposed rule includes an expansive definition of the term "misconduct," which would most likely include simple reporting mistakes. 80 Fed. Reg. 621. Similar provisions are also proposed which would allow ONRR to establish the values of a lessee's transportation, processing, and washing allowances.

These changes follow ONRR's May 20, 2014 proposed rulemaking on Amendments to Civil Penalty Regulations, which seeks to broaden ONRR's enforcement authority under the Federal Oil and Gas Royalty Management Act (FOGRMA). ONRR's commentary to the January 6, 2015 proposed rule, however, states the default valuations and allowances established by ONRR for payor "misconduct" would be "different than, and in addition to, any

violations subject to civil penalties under FOGRMA . . . and its implementing regulations." 80 Fed. Reg. 621. The default provisions for royalty valuations and allowances will apply to Federal oil and gas leases and Federal and Indian coal leases.

In determining a default royalty value, ONRR will consider a list of discretionary factors which include:

- The value of like-quality oil, gas and coal from nearby leases, plants or mines;
- Public sources of market information;
- Information reported to ONRR on various ONRR reporting forms; and
- "Any information ONRR deems relevant" regarding the lease.

In its commentary to these factors, ONRR explains in the context of oil leases that the new default provision will allow "ONRR to consider any criteria [it] deem[s] relevant, as well as criteria similar to the current gas valuation benchmarks under 30 CFR 1206.152(c)(1) and (2) and 1206.153(c)(1) and (2)." 80 Fed. Reg. 614.

The Elimination of Benchmarks for Gas and Coal Royalty Valuations

In stark contrast to the above, the proposed rule eliminates the valuation benchmarks currently used to value royalties for non-arm's-length sales from Federal gas leases. The elimination of these benchmarks was discussed in the ANPR and at the 2011 workshops, and is being proposed to offer greater simplicity and clarity to payors and ONRR. In lieu of applying benchmarks, ONRR intends to value these royalties based on gross proceeds from first arm's-length resales ("affiliate resales"), index prices, or weighted average pool prices. ONRR similarly proposes to eliminate the use of benchmarks to value royalties for non-arm's-length sales from Federal and Indian coal leases, and intends to similarly base these royalties on affiliate resales. ONRR also proposes to "value sales of coal between cooperative members using the first arm's-length sale or a netback methodology." 80 Fed. Reg. 609.

Other Noteworthy Changes

Other notable changes proposed in the rule include:

· The elimination of reporting of transportation factors for oil royalties

30 C.F.R. § 1206.110(g) currently allows payors to report their oil transportation allowances by using transportation factors, in lieu of reporting itemized transportation costs. ONRR would like to eliminate the use of transportation factors under the current rules, and require payors to report their actual transportation costs as allowances.

· The elimination of line fill and pipeline losses as part of a non-arm's-length transportation allowance

ONRR intends to eliminate the ability for payors to include line fill and pipeline losses expenses as a component of their non-arm's-length transportation allowances. ONRR takes the position that these expenses are part of the cost to market oil and gas, and should be disallowed as deductions.

· Written contract requirements

ONRR plans on requiring payors to have written sales and transportation contracts, which can be submitted to ONRR. ONRR's commentary to the proposed rule explains that "[w]ithout the applicable sales, transportation, and/or processing contracts, neither the lessee nor ONRR can verify that Federal royalties are properly paid." 80 Fed. Reg. 622. If a payor does not have a written agreement in place, ONRR intends to exercise its discretion to determine the applicable royalty value or

transportation or processing allowance under the proposed default provisions discussed above.

In addition, ONRR invited comments on: creating standardized "schedules" for transportation and processing allowances, and ideas on reassessing royalties for non-arm's-length royalty valuations.

For additional information, please contact Jennifer Bradfute.

Revised Draft Guidance Regarding Greenhouse Gas Emissions and Climate Change in NEPA Reviews

Introduction: On December 18, 2014, the Council on Environmental Quality ("CEQ") issued revised draft guidance ("Revised Draft Guidance")[1] for analyzing greenhouse gas ("GHG") emissions and climate change impacts in National Environmental Policy Act ("NEPA") analyses. CEQ's Revised Draft Guidance replaces the CEQ's 2010 Draft Guidance. The Revised Draft Guidance's stated purpose is to improve the "efficiency and consistency of reviews of proposed Federal actions for agencies, decisionmakers, project proponents, and the interested public." Revised Draft Guidance at 1. The Revised Draft Guidance acknowledges that it "is not a rule or regulation, and the recommendations it contains may not apply to a particular situation based upon the individual facts and circumstances," and that the guidance "does not establish legally binding requirements in and of itself." *Id.* at 1, n.4. The Revised Draft Guidance thus leaves the Federal action agency with the discretion to determine whether and how to use the Guidance.

Although the Revised Draft Guidance states that its purpose is to improve efficiency and reduce litigation, the Revised Draft Guidance's recommendations may have the unintended consequence of increasing the complexity of NEPA analyses, especially for those agencies whose NEPA analyses have recently been challenged. In addition, to the extent an agency determines that a GHG analysis is required, preparing such an analysis may increase the already lengthy process of preparing a NEPA document, and may create additional burdens for agency staff.

The Revised Draft Guidance acknowledges that a meaningful analysis of climate change is "particularly complex" because of the global nature of climate change and the interrelationships among sources, causation and impacts. Revised Draft Guidance at 2. Nevertheless, the Revised Draft Guidance states that analyzing a "proposed action's climate change impacts and the effects of climate change relevant to the proposed action's environmental outcomes can provide useful information to decisionmakers and the public." *Id.* The Revised Draft Guidance encourages "focused and effective consideration of climate change," which is consistent with NEPA's rule of reason. Revised Draft Guidance at 2, 5. The Revised Draft Guidance emphasizes throughout the importance of adequately analyzing GHG emissions and climate change, while at the same time reiterating that any such analysis must be "subject to reasonable limits based on feasibility and practicality," *id.* at 11, and that analysis for analysis' sake is not the goal—rather the goal remains informed decision-making. *Id.* Thus, if the agency concludes that evaluating the effects of GHG emissions will not be useful to the decision making process or to the public, the agency should document that decision. *Id.* at 10.

Implications for the NEPA Process:

Applicability: The Revised Draft Guidance applies to "all Federal proposed actions, including individual Federal site-specific actions, Federal grants for or funding of small-scale or broad-scale activities, Federal rulemaking actions, and Federal land and resource management decisions."

Revised Draft Guidance at 8. The broad applicability of the Revised Draft Guidance is consistent with the CEQ regulations defining what federal actions require NEPA evaluation. The Revised Draft Guidance encourages agencies to apply the guidance to all new agency actions, and to the extent possible "build its concepts into currently on-going reviews." *Id.* at 31. Consequently, project proponents should coordinate with the action agency on how to address the Revised Draft Guidance.

General Principles: The Revised Draft Guidance states that climate change and GHG should be analyzed for "those proposed actions that involve emissions, or that have a long lifespan such that a changing climate may alter the environmental consequences associated with the proposed action." Revised Draft Guidance at 3.

The Revised Draft Guidance suggests a two-part analysis: Agencies should consider a proposed action's potential impacts on climate change as indicated by the action's GHG emissions, as well as the impact that climate change may have on the proposed action's environmental effects. *Id.* at 3. Also, the Revised Draft Guidance suggests that agencies should consider both short- and long-term effects and benefits of a project based on the agency's determination regarding the life of the project and the duration of the generation of emissions. *Id.* at 12.

The Revised Draft Guidance further suggests that agencies should provide a "frame of reference," such as "applicable Federal, state, tribal, or local goals for GHG emission reductions," *id.* at 14, and that agencies can use "projected GHG emissions and also, when appropriate, potential changes in carbon sequestration and storage" as a proxy for assessing potential climate change impacts. *Id.* at 8.

Qualitative versus Quantitative Analysis: The Revised Draft Guidance acknowledges that an agency retains discretion to perform either a qualitative or a quantitative analysis, depending upon the tools and information available. *Id.* at 15. The Revised Draft Guidance, however, notes that GHG estimation tools are widely available and have been broadly used, and that if such tools are available, "then agencies should conduct and disclose quantitative estimates of GHG emissions and sequestration." *Id.* at 15. Thus, agencies may feel obligated to undertake quantitative, rather than qualitative, analyses of GHG emissions.

If the projected emissions do not meet or exceed 25,000 metric tons of $CO_{2\text{-}e}$[2] emissions annually, an agency need not discuss projected quantitative GHG emissions, unless "quantification below that reference point is easily accomplished." *Id.* at 18. Including this reference point in the Revised Draft Guidance provides a useful trigger for agency analysis, but the suggestion that an agency may still need to include a quantitative analysis when quantification can be easily accomplished may create a litigation risk if an agency either does not undertake a quantification or does not explain why such analysis is not easily accomplished.

Cost-Benefit Analysis: The Revised Draft Guidance affirmatively states that a "monetary cost-benefit analysis need not and should not be used in weighing the merits and drawbacks of alternatives when important qualitative considerations are being considered." *Id.* at 16. If, however, an agency determines that it is appropriate to monetize costs and benefits, the Revised Draft Guidance states that the "Social Cost of Carbon"[3] protocol "offers a harmonized, interagency metric that can provide decisionmakers and the public with some context for meaningful NEPA review." *Id.* at 16. Agencies may now feel constrained to include a cost-benefit analysis, using the Social Cost of Carbon protocol.

Direct and Indirect Impacts: The Revised Draft Guidance recommends that emissions from "upstream

activities (that may occur as a predicate of the action under review) and downstream activities (that may occur as a consequence of the action under review) should be included in the NEPA analysis." *Id.* at 11. This recommendation, however, could be broadly construed contrary to United States Supreme Court precedent[4] holding that an agency need not consider, in its direct or indirect effects analysis, impacts the agency has no authority to prevent. This recommendation could lead an agency to discuss impacts beyond those required by NEPA, or could form the basis for a challenge to an agency's properly limited impact assessment.

Cumulative Impacts: CEQ does not expect that cumulative impacts of GHG emissions alone will necessitate an EIS. Revised Draft Guidance at 12. Rather, "agencies need to consider whether the reasonably foreseeable incremental addition of emissions from the proposed action, when added to the emissions of other relevant actions, is significant." *Id.* at 11-12.

Proportionality/Agency Discretion: The Revised Draft Guidance cautions that agencies should not rely on boilerplate text to avoid meaningful analysis. Revised Draft Guidance at 5-6. The Revised Draft Guidance states that an agency's analysis of GHG emissions "should be commensurate with the quantity of projected GHG emissions." *Id.* at 10. The Revised Draft Guidance throughout emphasizes meaningful, proportionate analysis. *Id.* at 10, 14-15, 18, 26. Nevertheless, agencies now may feel obligated to fully discuss GHG emissions and climate change, even when the proposed project will have limited or no GHG emissions or climate change impacts.

Alternatives: The Revised Draft Guidance suggests that agencies should discuss a comparison of GHG emissions caused by each alternative and mitigation measure, including the no-action alternative, if such a discussion "would be useful to advance a reasoned choice among alternatives and mitigation." *Id.* at 18-19.

Mitigation: The Revised Draft Guidance provides: "[A]gencies should consider reasonable mitigation measures and alternatives as provided for under the existing regulations to lower the level of the potential GHG emissions." *Id.* at 19. The Revised Draft Guidance suggests that agencies consider the "quality" of the proposed mitigation measures, including "permanence, verifiability, enforceability, and additionality." *Id.* The Revised Draft Guidance sets forth specific examples of alternatives that may be considered for their ability to reduce or mitigate GHG emissions, including energy efficiency, renewable energy, carbon capture and sequestration, and capturing fugitive GHG emissions. *Id.* The Guidance's suggestions for alternatives and mitigation may create unnecessary complexity for action agencies.

Vulnerable Areas or Populations: The Revised Draft Guidance suggests that particular impacts of climate change on areas and populations considered vulnerable to the effects of climate change be considered in the action's design or selection of alternatives. *Id.* at 23-24. The Revised Draft Guidance "recommend[s] that agencies periodically engage their environmental justice experts…to identify interagency approaches to impacts that may have disproportionately high and adverse human health or environmental impacts on minor populations and low-income populations." *Id.* at 28. This recommendation may result in agencies determining that additional public involvement is necessary.

Scoping: The scoping process should identify elements of the proposed agency action related to climate change, such as the nature, location, timeframe, and type of proposed action. *Id.* at 26.

Incorporation by Reference: Agencies do not need to undertake exhaustive research or analysis of potential climate change impacts in the project area or on the project itself, but may "summarize and incorporate by reference the relevant scientific literature." Revised Draft Guidance at 27. The Guidance identifies the peer-reviewed assessment from the United States Global Change Research Program and underlying technical reports and notes as "[p]articularly relevant" the "reports on climate change impacts on water resources, ecosystems, agriculture and forestry, health, coastlines, and arctic regions in the United States." Revised Draft Guidance at 27.

Modeling and Using Available Information: The Revised Draft Guidance acknowledges the limitations of climate modeling, and encourages agencies to disclose the limitations of the model when discussing the extent to which the agency relied on a particular model. *Id.* at 27. The Revised Draft Guidance also reiterates that agencies "should exercise their discretion to select and utilize tools, methodologies, and scientific and research information that are of high quality and most appropriate for the level of analysis and decisions being made." *Id.* at 28.

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[1] Available here.

[2] "The common unit of measurement for GHGs is metric tons of CO2 equivalent (mt CO2-$_e$)." Revised Draft Guidance at 1, n.1

[3] Citing "Technical Update of the Social Cost of Carbon for Regulatory Impact Analysis," (November 2013), available here.

[4] Dep't of Trans. v. Public Citizen, 541 U.S. 751, 767-68 (2004).

Understanding and Planning for How Bankruptcy Might Impact Responsibility for Environmental Liabilities

Introduction

This article examines the sometimes uneasy intersection between laws addressing responsibility for environmental liabilities and the protections afforded to debtors under the United States Bankruptcy Code. Following a number of industrial related environmental incidents and mishaps, in 1976 Congress passed the Resource Conservation and Recovery Act of 1976 ("RCRA"), by which Congress intended to reduce generation of toxic and hazardous wastes and ensure the proper disposal, treatment, and storage of such wastes. Soon thereafter in 1980, Congress passed the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA") to redress decades of unregulated contamination by imposing cleanup costs on contaminators.[1] Liability for violations of these statutes effectively transforms an entity into an environmental debtor of federal or state governments, or both.

In the same time period Congress created the U.S. Bankruptcy Code (the "Code"), which codified a legal regime that previously only existed as common law.[2] A fundamental goal of bankruptcy is to give a debtor a "financial fresh start."[3] A second goal of the Code ensures that similarly situated creditors will receive equal treatment in recovering claims from the debtor.[4] To effectuate these two goals, the Code contains several provisions related to the timing, amount, and status of distributions from a debtor's estate.[5] As discussed in this article, the Code's plain language and twin goals can pose unique challenges in the context of the somewhat conflicting statutory mandates of RCRA and CERCLA.[6]

I. The Conflicting Goals of Bankruptcy and Environmental Laws

The "fresh start" offered by the Bankruptcy Code is achieved through a defined process that assesses a debtor's liabilities and minimizes the burden of such liabilities on the debtor outside of the bankruptcy process.[7] In carrying out this goal the Code and bankruptcy courts attempt to:

> identify and reduce to a dollar amount all of the debtor's pre-bankruptcy debts; to divvy up the debtor's assets fairly for a final distribution on account of such debts, and to enable the debtor to emerge from the process with a fighting chance at future profitability. The more debts that are resolved through the bankruptcy, the less burden the debtor will have thereafter.[8]

Several specific Code provisions are intended to achieve the "fresh start" goal.[9] These provisions include establishing what a "claim" is and whether the claim is subject to the bankruptcy process, implementing an automatic stay on collection of debts, and establishing an administrative expense and priority scheme.[10] Manifesting the purpose of the "fresh start" goal by invoking these various provisions, however, can conflict with the goals of RCRA and CERCLA, whose purposes are to identify potentially responsible parties ("PRPs") and assess the cost of cleanup against those deemed responsible for harming the environment and jeopardizing human health.[11]

A. Environmental Injunctions and Clean Up Orders in Bankruptcy "Claims"

In keeping with the "fresh start" goal, the Code broadly defines those types of items classified as a "claim" to include as many debts as possible within the debtor's bankruptcy discharge.[12] A claim includes: (1) any right to payment, regardless of whether the right has been reduced to a judgment or is liquidated, contingent, legal, equitable, etc.; or (2) any right to an equitable remedy for breach of performance, if the breach would give rise to a right to payment.[13] Despite the Code's broad definition of a claim, only those items that would create a right to payment of money are a "claim" within the meaning of the Code.[14]

Because only "claims" are dischargeable in bankruptcy, only those liabilities of the debtor properly classified as a right to payment will be discharged.[15] The liabilities that fail to come within the Code's definition of a "claim" survive bankruptcy and a debtor is still liable for such claims after discharge.[16] Courts thus have had to grapple with the question of whether injunctions and clean up orders under RCRA and CERCLA are "claims" for purposes of the Code.

Generally, courts have held that a debtor's obligation to comply with a RCRA or CERCLA clean up order or injunction is not a right to payment.[17] Because these obligations do not amount to a right to payment they are not a "claim" within the meaning of the Code and remain in place, unaffected by a debtor's bankruptcy discharge.[18] Less clear is the treatment of a RCRA or a CERCLA clean up order or injunction that in bankruptcy has the *effect* of a money judgment.

Two cases, *Ohio v. Kovacs* and a subsequent Second Circuit case, *Chateaugay I*, seem to create two propositions regarding clean up orders that have the *effect* of a money judgment.[19] First, when an injunction or court order, even impliedly, converts equitable relief to a money judgment, such an order is then a "claim" within the meaning of the Code.[20] Because the once equitable relief is now a claim, it is also subject to the discharge provisions of Chapter 7 and Chapter 11, permitting a debtor-PRP to reduce its environmental liabilities in bankruptcy.[21] Second, because only those injunctions that can be reduced to a money judgment may be a "claim" and because the express statutory language of RCRA does not allow for a cause of action for a money judgment, injunctions or clean up orders

under RCRA can never be a claim within the meaning of the Bankruptcy Code.[22] Allowing a debtor-PRP to reduce its environmental liabilities, especially in cases like *Kovacs* and *Chateaugay I*, where the debtor knew its actions violated the law, while comporting with the meaning of the Code conflicts with the purpose of CERCLA to hold those responsible for contaminating the environment and endangering human health.

B. Automatic Stays

The automatic stay ("Stay") afforded by Section 362 of the Code temporarily halts collection on *any* action against a debtor or its property by creditors the moment the debtor files its bankruptcy petition.[23] This provides the debtor with financial "breathing room" and allows a debtor to identify the extent of its liabilities and create a plan to address these liabilities in its bankruptcy.[24] Invoking the Stay plays a fundamental role in a debtor's successful emergence from bankruptcy.[25] Section 362, nevertheless, excepts certain types of actions from the Stay's protection.[26]

One recognized exception to Section 362 is an action enforced by a governmental body pursuant to its police power.[27] The Code, however, provides an exception to the governmental body police powers exception.[28] While a governmental body enforcing actions pursuant to its police powers is excepted from the Stay provisions, actions by this power are not excepted if the governmental body seeks to enforce a money judgment, essentially an exception to the exception.[29] But the Code fails to define what types of judgments qualify as "money judgments" within the meaning of either Section 362 or the larger Code itself.[30] Accordingly, controversy arises when a governmental body takes an action, such as imposing a clean-up order or injunction that is not a money judgment on its face, but which does require a debtor-PRP to expend money to clean up a contaminated site or otherwise comply with an environmental statute.

Penn Terra, a Third Circuit case, is the leading authority analyzing the issue of whether an injunction or court order that requires a debtor to spend money is equivalent to a "money judgment" under the Bankruptcy Code.[31] The Pennsylvania state Department of Environmental Protection (DEP) obtained a state court injunction requiring *Penn Terra* to comply with the backfill requirements to prevent toxic discharges from its coal mining operations.[32] Shortly after the state court ordered the injunction, *Penn Terra* filed for Chapter 11 bankruptcy.[33] When the DEP attempted to compel *Penn Terra* to comply with the injunction *Penn Terra* filed contempt charges against the DEP for violating the Stay.[34]

In defining a "money judgment" the court looked to two factors. First, the nature of the injuries the injunction sought to remedy, meaning did the injunction seek to remedy past harm—usually satisfied by money damages—or future harm, where mere payment of payment of money generally never satisfies harm done.[35] Second, and ultimately, the court looked at whether the injuries are those traditionally rectified by a money judgment.[36] Because the nature of the injunction prevented future harm and the "mere payment of money without more. . . could not satisfy" the backfill and topsoil injunction, the injunction remained in place unaffected by the Stay.[37]

In the years following the *Penn Terra* decision, the majority of bankruptcy courts have narrowly construed the term "money judgment" to determine when an injunction or court order may be affected by the Stay provisions by applying the two factor test delineated in *Penn Terra*.[38] Such an interpretation balances those interests served by the Stay—preserving the value of a bankruptcy estate—with the policies behind compelling compliance with environmental regulations of protecting the public health and environment.[39] The express language of Section 362(b)(4) recognizes that occasionally bankruptcy policy

must yield to another authority by excepting certain actions from the Stay.[40] Moreover, such an interpretation is congruent with 11 U.S.C. §959(b), which requires a debtor or trustee to manage and operate a bankruptcy estate in compliance with state law, including state environmental laws.[41]

C. Administrative Expense Priority

Generally, Section 507 of the Code—"Priorities"—proscribes the order by which creditors' claims and expenses are paid out of the bankruptcy estate.[42] Section 503—"Allowance of Administrative Expenses"—provides an exception to the general payment scheme in 507 for certain categories of expenses and establishes a different priority for certain types of claims in bankruptcy.[43] Section 503 provides an expense priority for any goods or services rendered to the estate after the date of filing, or rather "post-petition," that are "[ ] *actual*, *necessary*, costs and expenses for *preserving* the estate."[44] In order to obtain an administrative expense the goods or services rendered to the estate must (1) be actual, (2) be necessary, (3) preserve the estate, and (4) occur post-petition.[45] Claims and expenses outside of these four criteria do not meet the special priority requirements and are subject to the priority payment established in Section 507. The Code's Section 503 administrative expense priority criteria cause a handful of conflicts with the practical abilities to remediate environmental contamination.

Initially, the provision requires the expense to be "actually" incurred.[46] In many instances, however, environmental claims are highly prospective or even completely unknown when the debtor-PRP files bankruptcy.[47] As a result, there often are no post-petition expenses "actually" incurred that are directly traceable to the particular bankruptcy estate because either a link has yet to be established between the contamination and the estate or the contamination is still undiscovered. Further, actions causing environmental contamination often occur pre-petition, ceasing either before the debtor files its petition.[48] Because this contamination ceases before the debtor files its petition, the liability does not meet the fourth criteria of occurring "post-petition" and therefore cannot receive a payment priority under Section 503.[49] Lastly, an action causing contamination may have occurred entirely pre-petition, but response costs may have only been incurred post-petition. In these instances, courts have struggled with what priority to assign such claims.[50]

Courts have determined that monetary claims for response costs wholly incurred pre-petition or for future response costs arising out of wholly pre-petition actions causing contamination do meet the four criteria required under Section 503(b)(1)(A) to be an administrative expense.[51] Accordingly, costs or expenses incurred as a result of these wholly pre-petition expenses or actions causing contamination are general unsecured claims paid according to the priority established by Section 507.[52] Less evident is the priority assigned to environmental liabilities when the actions causing contamination occurred wholly pre-petition, but the costs to clean up the contamination occurred wholly post-petition.

Across the federal circuits a trend has developed in how to determine when post-petition clean-up costs for wholly pre-petition actions may be entitled to an administrative expense claim. Generally, clean-up costs, for example CERCLA response costs (in essence, costs of remediating environmental contamination), will receive an administrative expense claim if (1) the contamination poses an imminent threat to public health and the environment or (2) to bring a debtor-PRP's site into compliance with applicable environmental laws.[53] Granting an administrative expense for these releases, because they pose an imminent harm to public health, acknowledges the balance between the policies of the Code and those of the environmental

statutes as discussed by the Third Circuit in *Penn Terra*, albeit in a context involving different sections of the Code.[54]

Likewise, courts grant an administrative expense priority for the cost to bring a site into compliance with environmental laws because compliance with these laws is a "benefit" to the estate, i.e., one that in effect has "preserved" the estate by conferring such a beneficial interest upon it.[55] Allowing this priority makes it less likely that the public will end up footing a huge bill for response costs because they are given a priority, as opposed to being a general unsecured claim, which regularly do not get paid in bankruptcy because of shortfalls in the estate.

II. The Next Big Issues in Bankruptcies Involving Environmental Liabilities

The next battlegrounds for environmental liabilities in bankruptcy will likely stem from bankruptcies involving wind farms and oil and gas operators that have employed hydraulic fracturing, or "fracking." Both of these industries have experienced massive growth in the last decade but share characteristics that commonly lead to bankruptcy.[56]

Wind power as a source for electricity on a large scale, at least in the United States, is in many ways still a developing technology. Profitably harnessing wind has largely depended on the federal Production Tax Credit ("PTC").[57] The PTC provides an income credit on a wind developer's bottom line, on a per kilowatt hour ("kwh") basis.[58] Once passed by Congress the PTC runs for a period of 10 years.[59] For projects beginning construction on or before December 31, 2013, the PTC was $.023 per kwh.[60] While seemingly small, this amount is often the difference between a developer's breaking even or losing money in the first 10 years of the project.[61] In fact, even with this credit in place it takes the majority of wind farms 10 years to break even at current electricity prices.[62] Additionally, wind developers tend to be highly leveraged, generally putting down less than 10 percent of the total cost of a farm.[63]

Currently, the per turbine "installed cost" of the average turbine in the U.S., meaning a turbine with a 2.0-2.5 kilowatt ("kw") rating, costs $1 million dollars.[64] Depending on the physical location of the turbine, offshore or onshore for example, turbines are 200-500 feet in height, utilize 60 acres per installed kwh, and contain a vast array of moving metal parts and lubricating liquids for proper operation of the turbine[65] As a result, proper, yet costly, maintenance of these turbines is critical to ensuring protection of human and environmental health. Given the nature of the industry as one whose profitability is largely intertwined with the political climate, highly leveraged, capital intensive, and subject to the volatile commodities market, wind farm developers are potential candidates for bankruptcy because even a small downward move in the price of electricity could significantly impact a developer's bottom line.

Oil and gas production in shale or expired fields via the fracking process involving directional drilling on a large scale is a relatively recent phenomenon, even though fracking itself has been employed for several decades. Although not directly reliant on any single targeted tax credit to break even, like wind, fracking is an expensive technology.[66] The cost to frack a single oil well can be as high as $6.4-$13 million dollars.[67] Accordingly, to break even in fracking, it is generally believed that oil must remain above the $100 per barrel mark.[68] Moreover, producers in the fracking business tend to be highly leveraged, and access to this credit is the result of the sustained high price of oil.[69]

In terms of the actual process, fracking utilizes "frack fluid"—a mixture of water, chemicals and propants injected at high pressure to prop open subterranean rock spaces so that oil may flow out after the frack fluid is withdrawn.[70]

Fracking is generally understood to at least create a potential for environmental contamination if there is inadequate "casing" of the wells to protect water bearing formations passed through to get to the deeper zones being fracked. Fracking is likewise capital intensive, highly leveraged, and risky. Because in many instances the bankruptcy courts do not uniformly recognize the underlying policy interests of environmental statutes and because the nature of these industries makes them vulnerable to market changes, it is wise to consider protection outside of the Code to guard against potential environmental contamination.

III. Means of Avoiding Environmental Liability Issues in Bankruptcy

One way to manage environmental liabilities outside of the Code's protections is for parties to employ removal or restoration bonds in their contractual dealings. Removal or restoration bonds may be provided for in a wind or oil and gas lease and require the lessee to post a bond to ensure that when operations cease, the surface of the land is restored to its pre-existing state and all subterranean matter used in operations is also removed from the land.[71] When the lessee must post the bond is also important. While the lessee need not post the bond before or even immediately after the commencement of operations, it is important that a lessee post the bond sooner, rather than later.[72] The exact timeframe depends on the term of years of the particular lease and the break-even point for the industry.[73]

Next, it is important to specify the credit rating of the bonding company in the lease. A removal or restoration bond is no good if the bonding company itself is also experiencing a cash shortfall.[74] Last, the lease must require the bonding company to be a third party non-affiliate of the lessee. In the event of a bankruptcy the affiliated bond would likely collapse into the property of the estate under Section 541 of the Code.[75] Once collapsed into the estate the bond would be available as payment to secured and other creditors in compliance with Sections 507 and 503 and any environmental liabilities would very likely receive general unsecured claims status against the estate, making payment unlikely.[76]

In lieu of a removal or restoration bond, a lessee could also obtain a security interest in a certificate of deposit ("CD") for an agreed upon amount to ensure surface restoration and protect against any environmental damage that may occur from operations on the lessee's property.[77] A developer, however, is less likely to commit to a CD because it ties up large amounts of capital. In the past, escrow accounts have been used to combat restoration and environmental concerns. Escrow accounts, like a bond from an affiliated company, would collapse into the bankruptcy estate and once collapsed would be available to secured creditors, rather than general unsecured creditors, the likely status of a lessee-environmental creditor in bankruptcy.[78]

Planning for bankruptcy during the negotiation process involving a wind or oil and gas lease while the lessee is still solvent provides the parties with the best chance of ensuring protections against environmental liabilities and the inadvertent loss of those protections due to the desirable, but sometimes conflicting, goals of the Code and the laws ensuring environmental protection and responsibility.

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[1] Sandra Franco and Melissa Murray, *Treatment of Environmental Liabilities in Bankruptcy*, (1999), http://www.bingham.com/Publications/Files/2011/04/Treatment-of-Environmental-Liabilities-in-Bankruptcy.

[2] UNITED STATES COURTS, BANKRUPTCY BASICS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Process.aspx (last visited March 30, 2014).

[3] *Id.*

[4] Lisa E. Waisbren, *Abandonment of Toxic Wastes Under Section 554 of the Bankruptcy Code*, 71 MARQ. L. REV., 353 (1986).

[5] *See* Waisbren, *supra* note 4 at 354.

[6] A detailed discussion of the RCRA and CERCLA legal regimes, which are used here as examples of environmental laws, and exactly how environmental laws give rise to liabilities that may or may not become the subject of bankruptcy proceedings under the Code, are generally beyond the scope of this article.

[7] *See* Franco, *supra* note 1 at 343.

[8] *Id.*

[9] *Id.*

[10] *See id.* at 344-47.

[11] *Id.* at 341.

[12] *See* 11 U.S.C. §105(A)-(B) (2013).

[13] *Id.*

[14] *Id.*

[15] 11 U.S.C. §727(b); 11 U.S.C. §523(a)(3); 11 U.S.C. §1141.

[16] *See* 11 U.S.C. §727(b); 11 U.S.C. §1141.

[17] *AM Int'l v. Datacard Corp., DBS, Inc.,* 106 F.3d 1342 (7th Cir. 1997); *In re Chateaugay I*, 944 F.2d 997 (2d Cir. 1991); *In re Torwico Elec., Inc.,* 8 F.3d 146 (3d Cir. 1993).

[18] *AM Int'l,* 106 F.3d at 1342; *Chateaugay I*, 944 F.2d at 997; *Torwico*, 8 F.3d 146.

[19] *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985); Chateaugay *I*, 944 F.2d at 997.

[20] *Chateaugay I*, 944 F.2d at 999.

[21] 11 U.S.C. §727(b) (2013); 11 U.S.C. §523(a)(3)(2013).

[22] 42 U.S.C. § 6972(a); *see Kovacs*, 469 U.S. at 278; *see Chateaugay I*, 944 F.2d at 997.

[23] 11 U.S.C. §362(a)(1)-(8) (2013).

[24] *See* 11 U.S.C. §362(a)(1)-(3) (2013).

[25] *Penn Terra Ltd. v. Dep't of Envt'l Resources*, 733 F.2d 267, 271 (3d Cir. 1984).

[26] 11 U.S.C. §362(b) (2013).

[27] 11 U.S.C. §362(b)(4) (2013).

[28] *Id.*

[29] *Id.*

[30] *See* 11 U.S.C. §101; *see* 11 U.S.C. §362 (containing no definition for "money judgment").

[31] *Penn Terra Ltd.*, 733 F.2d at 267; *City of New York v. Exxon Corp.*, 932 F.2d 1020 (2d. Cir. 1991) is another leading circuit case addressing whether compelling the debtor-PRP to comply with an injunction is the equivalent of a money judgment stayed by section 362. The Second Circuit paralleled *Penn Terra's* reasoning to determine expenditure of money alone does not convert an injunction to a money judgment stayed by section 362. *Id.*

[32] *Penn Terra Ltd.*, 733 F.2d at 267.

[33] *Id.* at 270.

[34] *Id.*

[35] *Id.* at 278.

[36] *Id.*

[37] *Id.*

[38] *New York v. N. Storonske Cooperage Co.*, 174 B.R. 366 (N.D.N.Y. 1994); *Chateaugay I*, 944 F.2d at 997.

[39] *Penn Terra Ltd.*, 733 F.2d at 278.

[40] *Id.*

[41] 28 U.S.C. §959(b)(2013).

[42] 11 U.S.C. §503 (2013).

[43] *Id.*

[44] 11 U.S.C. §503(b)(1)(A) (2013) (emphasis added).

[45] *Id.*

[46] *Id.*

[47] *See* Franco, *supra* note 1 at 351.

[48] *See id.*

[49] *See id.*

[50] *See id.*

[51] *In re Nat'l Gypsum*, 139 B.R. 397 (N.D. Tex. 1992); *In re Mahoney-Troast Construc. Co.*, 189 B.R. 57 (Bankr. D.N.J. 1995).

[52] *In re Nat'l Gypsum*, 139 B.R. at 397; *In re Mahoney-Troast Construc. Co.*, 189 B.R. at 57.

[53] *Chateaugay I*, 944 F.2d at 1010-11; *In re Conroy*, 24 F.3d 568 (3d Cir. 1994); *In re Wall Tube & Metal Prod. Co.*, 831 F.2d 118, 123-124 (6th Cir. 1987).

[54] *Penn Terra Ltd.*, 733 F.2d at 278.

[55] *Wall Tube & Metal Prod. Co.*, 831 F.2d at 123-124.

[56] Asjylyn Loder, DREAMS OF U.S. OIL INDEPENDENCE SLAMS AGAINST SHALE COSTS, http://www.bloomberg.com/news/2014-02-27/dream-of-u-s-oil-independence-slams-against-shale-costs.html (last visited March 30, 2014); DATABASE FOR STATE RENEWABLES & EFFICIENCY, http://dsireusa.org/incentives/incentive.cfm?Incentive_Code=US13F (last visited March 30, 2014).

[57] George Humphrey, Partner, Andrews Kurth, LLP, Guest Lecturer at Texas Tech School of Law: Wind Financing and Lease Agreements, (Mar. 11 & Apr. 17, 2014)

[58] *Id.*

[59] *See* Loder, *supra* note 56; *see* DATABASE FOR STATE RENEWABLES & EFFICIENCY, *supra* note 56.

[60] *Id.*

[61] Humphrey, *supra* note 57.

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] Loder, *supra* note 56.

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] FRACFOCUS, HYDRAULIC FRACTURING AND HOW IT WORKS, http://fracfocus.org/hydraulic-fracturing-process (last visited March 30, 2014).

[71] Humphrey, *supra* note 57.

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] 11 U.S.C. §541 (2013).

[76] *Nat'l Gypsum*, 139 B.R. at 397; *Mahoney-Troast Construc. Co.*, 189 B.R. at 57.

[77] UCC §9-203 (2013).

[78] 11 U.S.C. §541 (2013).

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Jennifer Clements
John Cooney
Earl DeBrine
Joan Drake
Tomas Garcia
Marco Gonzales
Paul Halajian
Stan Harris
Gbenoba Idah
Zoë Lees
Marte Lightstone
George McFall
Meg Meister
Cristina Mulcahy
Brian Nichols
Benjamin Nucci
Maria O'Brien
Lorena Olmos
Debora Ramirez
Bill Scott
Christina Sheehan
Lynn Slade
Walter Stern
Sarah Stevenson
R.E. Thompson