THE FIELDWOOD ENERGY SAGA: INSTANT IMPACT AND LONG-TERM CONCERNS FOR SURETIES

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Fool's Errand – *Merriam-Webster = "A needless or profitless endeavor."*

By the time this Newsletter is out, the confirmed chapter 11 plan of Fieldwood Energy, LLC and affiliates ("FWE") will have gone effective and more than twelve months of bruising battles for all involved will be in the rearview mirror . . . for now. For many who did not follow the case, you might ask, "what was the Fieldwood Saga?" For the nearly two dozen sureties that lived it day by day,[30] another question might be, "What really happened to us . . . and, was it good or bad?" For nearly everyone who is reading this article with interest, the more meaningful questions will ultimately become, "What are the immediate takeaways?" and "What will be tomorrow's lasting impact, if any?"

To start down the path of analyzing the FWE case might certainly seem like a fools' errand. For the surety/bankruptcy practitioner, the FWE case involved nearly every aspect of the convergence of surety law and bankruptcy law, often turning many long-held assumptions and established practices on their head. The phrase "No good deed goes unpunished," was uttered frequently in hearings in this case, but it literally could apply to any participant against any other participant at some point, often with each side believing that their purported good deeds were the only ones truly being punished. An old legal axiom holds that when everyone leaves a mediation a little unhappy, the result is usually considered to be a good one. Yet, when everyone leaves the FWE case unhappy, it may just be bad law and bad precedent.

So, with these ideas in mind, this article will attempt to explain to the casual surety observer what the case involved and discuss some short-term and long-term impacts for sureties in bankruptcy. Unfortunately, many fundamental surety/bankruptcy issues raised in this case ultimately went unresolved and will need to be further vetted in future bankruptcy cases. One certain thing is that the tactical and practical impact of FWE to sureties and their counsel are sure to be tested in the coming months and years.

Was This Result Inevitable?

Looking back on the twists and turns of the FWE case, one might conclude that the result was inevitable. FWE was an oil and gas ("O&G") exploration and production ("E&P") company operating largely in the shallow waters of the Gulf of Mexico continental shelf. In the years leading up to its' 2020 chapter 11 bankruptcy case, FWE was also operating in and drilling the deep water areas of the Gulf. It was one of the largest operators in the Gulf with over 300 platforms spread across over 1.5 million

[30] Authors' note: My law firm represented, and continues to represent, one of the impacted sureties in the FWE case, as have many readers and contributors of this Newsletter. The opinions expressed herein are meant to be general impressions and to raise broad discussion points. These issues in no way reflect the opinions and positions of any surety involved in the case. But, if you cannot take New York out of the New Yorker or Texas out of the Texan, you might find that the author just might be a little biased in any critique of the results in this case.

gross acres. Prior to filing bankruptcy, FWE maintained pipelines and oil and gas wells producing more than 79,410 barrels of oil equivalent per day. Like most E&P companies, it borrowed heavily to conduct strategic acquisitions and new drilling. At the time of filing, FWE had approximately $1.8 billion in secured debt, with an estimated collateral value much lower due to the then-current price of oil.[31]

Under U.S. environmental and regulatory law, E&P companies are liable for all environmental cleanup costs associated with their wells and platforms, called plugging and abandonment ("P&A") obligations, once those wells cease producing. To satisfy these P&A obligations, FWE created a web of financial assurances in the form of letters of credit, some backed by surety bonds, and direct surety bonds. Some bonds were issued directly to the U.S. Bureau of Ocean Energy Management ("BOEM") for P&A liabilities.[32] Since federal regulations also hold prior owners in the chain of title of these wells ("Predecessors") responsible for the same P&A for which FWE was primarily responsible, some bonds were also issued on behalf of FWE to these Predecessors (e,g, Chevron, Exxon, BP, ENI) when the O&G properties and existing wells were purchased by FWE. Still other bonds covered myriad permitting and operating obligations required by the U.S. Government, the State of Texas, and the State of Louisiana.

At the time of FWE's 2020 bankruptcy filing, the total P&A liability was estimated to be between $2+ billion (FWE's estimate) and $12+ billion (BOEM's estimate). While the drastic drop in the price of oil made it virtually impossible for FWE to meet its P&A obligations in the near term, the total cost of P&A is speculative and the timing of P&A can be manipulated by FWE for currently operated wells.

But was the bankruptcy filing and its ultimate result inevitable due to tragic circumstances? Or was it a strategic choice to take advantage of tactical timing? When the case was filed in August of 2020, after several months of the COVID-19 Pandemic and when oil was trading at less than $30/barrel, the filing itself was inevitable based upon financial covenant breaches.[33] However, when FWE's plan was confirmed in June of 2021, oil prices were holding steady at or above $70/barrel, so many of the worst economic predictions that formed the basis of FWE's negotiated plan were no longer at play.

The Plan Hatched By FWE, Its Lenders and Select Predecessors.

In the summer of 2020, with no end in sight for the COVID-19 Pandemic, FWE reached an agreement with certain of its lenders and its largest Predecessor-creditor to push a plan of reorganization that would have a huge effect on most surety bond providers. The Predecessor in question, Apache Corporation ("Apache"), was a long-standing Gulf participant and FWE agreed to assume its P&A obligations in exchange for FWE's purchase of Apache's O&G properties in 2015. The legacy Apache assets comprised as much as 60% of FWE's outstanding P&A obligations, estimated by FWE at the beginning of the case at $1.2 billion.

FWE's proposed plan of reorganization ("Plan") called for FWE to sell its most valuable deepwater properties to an affiliate created by its first lien lenders ("Newco"), with management largely remaining in place. The remaining assets would then be divided into (1) FWE I, a newly formed entity that would contain only the legacy

[31] In 2018, FWE also filed chapter 11 bankruptcy. Its debt structure at that time was based upon $95/barrel oil and it had dipped to around $60/barrel, forcing a debt-for-equity swap in its confirmed plan that reduced its $3.286 billion capital structure by more than $1.6 billion. In the 2018 case, for most sureties, their bonds and indemnity agreements were maintained and allowed to "ride through" unaffected. This was not the case in FWE's 2020 chapter 11 bankruptcy, termed in bankruptcy parlance, as a "chapter 22 case."

[32] BOEM and the U.S. Bureau of Safety and Environmental Enforcement ("BSEE"), both agencies under the U.S. Department of the Interior, regulate all O&G operations offshore in federal waters.

[33] In the early days of the COVID-19 Pandemic, when most economic activity temporarily stopped, it got so bad that oil was trading at -$20/barrel, and production companies were *paying* distributors to take their oil away because they were at capacity and had nowhere to store what was being produced.

Apache properties, and (2) FWE III, the remnants of legacy FWE where all remaining assets with potential value were placed. Finally, other remaining assets with no discernable value were simply to be "abandoned" by FWE and effectively returned to the U.S. Government to handle. FWE I and FWE III were tasked with using the remaining value in their assigned assets to reduce the P&A obligations as much as possible and then look to all of the financial assurances (direct bonds and letters of credit backed by other bonds) to finish the P&A and, if necessary, have the U.S. Government look to the Predecessors for payment of all remaining P&A obligations.

This restructuring was to be accomplished through a potentially controversial tactic recently being used in chapter 11 reorganizations - a "Divisive Merger." In this case, FWE (a Delaware LLC) would sell its deepwater assets to Newco via a bankruptcy sale under Section 363 of the Bankruptcy Code, then FWE would convert to a Texas LLC. From there, through the Texas merger statute,[34] FWE would "allocate" its assets and liabilities divisively to FWE I and FWE III as needed by the Plan proponents to accomplish their goals. The claims held by all general unsecured creditors ("GUCs") would be allocated to FWE III and a plan administrator was created to provide distributions to unpaid GUC claims from any residual value.[35] These claims were to include all indemnity claims of the surety bond providers except for the bonds that were ostensibly to follow the Newco assets (where those bonds would be used to protect Newco's future operations).

FWE I would exist to complete the P&A obligations on those assets, for which Apache was secondarily liable. The bonds protecting Apache were to be allocated to FWE I and to remain in effect, but the corresponding indemnity obligations of the FWE I assets were to be transferred to FWE III. As the Plan solicitation process wore on, other Predecessors with large obligations created an entity similar to FWE I, now called FWE IV. Still other Predecessors also agreed to fund FWE III to handle P&A on the FWE III assets and all abandoned assets to avoid having to do it themselves or at the government's insistence.

This complicated Plan was desirable to: (i) FWE's lenders, as they received the most valuable assets in exchange for debt forgiveness, while only having to assume P&A obligation for the purchased assets, or about 17% of P&A (the remaining 83% of P&A obligations are pushed into FWE I, FWE III, FWE IV or jettisoned)[36] and (ii) Apache, which, while still ultimately liable for P&A, could have all P&A completed through and using the assets of FWE I and not have to take on the P&A operations itself.

But was the Plan helpful to the sureties backing the Apache P&A obligations? What about sureties on the FWE III or FWE IV P&A obligations or the P&A obligations on the abandoned assets? What was to become of this bifurcated process where bond obligations were allocated among these post-plan entities, but the indemnity obligations funneled solely to a plan administrator with potentially nothing to distribute?

After months of wrangling over disclosures, shifting alliances and begrudging acceptance by many creditors that this Plan was a *fait accompli*, FWE's Plan was confirmed by the Bankruptcy Court on June 25, 2021, after a five-day trial on many plan issues and objections. Notably, the Plan ultimately received the backing of the U.S. Government. Several sureties settled some or all of their objections in order to obtain more favorable treatment, via negotiated accommodations to further protect their risk, or just to better brace for the inevitability of a confirmed plan. Other sureties persisted on isolated issues unique to their situation. In the end, the Bankruptcy Court overruled all remaining objections and approved the Plan,

[34] *See* TEX. BUS. ORG. CODE ANN., § 10.001, *et seq*. (West 2015).

[35] As of this writing, the return to GUCs is unknown. The plan administrator may use residual value in all assets to provide a distribution to these creditors, but the costs of P&A will have to be fully resolved before then, which could take more than ten years.

[36] If the lenders were to be asked, they would not necessarily call this a "benefit," but rather, more of a soft landing due to an unfortunate situation. Because this is a surety newsletter, their treatment will be considered a benefit.

finding that it met all standards required for confirmation under the Bankruptcy Code, all federal regulations and other applicable law.

The Plan's Impact on Sureties.

When assessing the confirmed FWE Plan's impact upon sureties, the first question to be asked is, "What was the alternative?" Here, one solution could have been for the entire FWE enterprise to convert to a chapter 7 liquidation, where a court-appointed trustee would oversee a wind down or sale of the assets and 100% of the estate's value is first applied to all P&A obligations, even before the secured creditors could get paid.[37] Setting aside the issue of whether certain creditor groups (sureties, Predecessors, general unsecured creditors) would have had the legal grounds to force a chapter 7 liquidation, one question faced by all involved was whether the bankruptcy system, the federal government and the Gulf environment as a whole could handle an immediate cessation on production on thousands of aging and potentially neglected Gulf wells.[38] Creditors had to weigh whether any expected value returned would pay for all P&A obligations, or whether the sureties and Predecessors would just get hit sooner than expected due to the potential cessation of production or when the suppressed prices received from a chapter 7 "fire sale" of assets were recovered.

On one level, the rights of sureties had to be balanced against some of the basic principles of the Bankruptcy Code. A fresh start for debtors is certainly one of the basic principles, although it is less applicable to the corporate debtor as opposed to the individual debtor. The concept of equal treatment of similarly situated creditors was heavily debated. In FWE, many sureties complained of the treatment, or lack thereof, afforded to their bonds and their indemnity agreements. Were the bonds to BOEM retained? What was to become of the sureties' principals? Did old FWE survive through these divisive mergers, or were new entities created? Were the indemnity agreements rejected? Abandoned? Did it matter if the indemnity agreements survived rejection? Many of these issues were unresolved because the established rights of sureties in these contexts did not fit neatly into the divisive merger Plan.

Conversely, sureties also had to evaluate whether the bankruptcy system should permit this seemingly "GoodCo/BadCo" scenario to prevail. Do the bankruptcy laws and federal environmental laws simply permit the abandonment of oil wells? What is the effect of the U.S. Supreme Court's *Midlantic* decision and its progeny on a case of the size of FWE?[39] At confirmation, the Bankruptcy Court held that the Bankruptcy Code ***does*** permit the abandonment of oil wells in this case, just like any other asset. But, in accordance with the *Midlantic* decision, the applicable federal agencies could prevent the transfers to Newco and the new entities (FWE I, FWE III and FWE IV) if they violated environmental and safety laws. Ultimately, because the transfers under the Plan were acceptable to the federal government and the interconnected and overlapping financial assurances were maintained (even if undefined), the Bankruptcy Court was probably inclined to overrule the objections of the remaining surety creditors.

Other issues considered and addressed by the sureties in this case were whether the bonds and corresponding indemnity agreements were a fully integrated single contract to be dealt with as one contract in the bankruptcy. Could that singular contract be split by a bankruptcy plan? Is the bond/indemnity contract really an executory contract that must be assumed or rejected under the Bankruptcy Code. Or is each agreement a separate unilateral contract that is an asset of the bankruptcy estate that can be abandoned? What is the effect of rejection of an

[37] There is ample but disputed case law cited in various pleadings in the case suggesting that P&A obligations are administrative claims, which must be satisfied before secured creditors get paid from proceeds of the assets.

[38] Remember the oily seagulls and ducks from the BP Deepwater Horizon oil spill? Or, the Exxon Valdez tanker spill?

[39] See *Midlantic Nat'l Bank v. New Jersey Dept. Of Env. Protection*, 474 U.S. 494 (1986) (holding that a bankruptcy trustee cannot abandon property in contravention of environmental statues; thus, abandonment may only be possible if the court formulates conditions that adequately protect the public health and safety).

indemnity agreement while the bond obligation survives? Can sureties which issued bonds to BOEM be forced to continue to bond BOEM on behalf of an entity that no longer exists? Did old FWE still exist? Can bonds be transferred to a new principal because the obligee remained the same? How do the sale procedures of the Bankruptcy Code (a Section 363 sale where the asset can be made "free and clear" of claims) affect sureties in their various postures?

A comprehensive assessment of each of these issues would warrant a separate article by itself.[40] However, if one peruses the various objections to the FWE Plan filed by the sureties, the Predecessors, the U.S. Department of the Interior, and other creditors, many of these issues are well briefed and fully vetted. Unfortunately, most of these issues were not resolved by a court ruling supported by applicable case law.

Some Nitty Gritty Legal Issues.

Without getting into too much detail for this article, a couple legal issues warrant a brief highlight:

Divisive mergers.

As to the divisive merger aspect of the Plan, two questions that must be answered are, (1) what does a divisive merger do, and (2) how is it being used in bankruptcy? Unlike a traditional merger, where two or more entities merge to become one, a divisive merger is used to have one entity divide into multiple entities where assets and liabilities are "allocated." The dividing entity is not required to terminate in connection with the division and may continue as a surviving entity. More importantly, an allocation of assets is typically not deemed to be an assignment or transfer of assets or liabilities. While the Delaware[41] and Texas[42] merger statutes do allow for dissenters' rights in some situations and under certain conditions, how those apply in a chapter 11 bankruptcy reorganization was certainly unchartered waters for most involved. Given the posture of the confirmed plan, though, many of these issues went unresolved.

Executory contracts.

The basic status in bankruptcy of a surety bond and its executory nature, where the bond obligation remains unfulfilled and the permit issued by the government based upon continuing surety credit remains outstanding and in effect, was the subject of numerous filings. The sureties argued, with some considerable support in the case law, that this relationship was executory and had to be dealt with under Section 365 of the Bankruptcy Code. Many court opinions also hold that a surety bond is a type of financial accommodation. Unfortunately, under Section 365(b) of the Bankruptcy Code, a financial accommodation is a type of executory contract that could not be assumed by the Debtors. So, what happens to the bond? What about the indemnity agreement that is inextricably intertwined with the bond? Can these agreements then be transferred? Can the obligations be separated and allocated in a divisive merger? What is the effect of rejecting this type of relationship? Is the effect of treating these contracts like the abandonment of an asset? What rights survive rejection? Many of these issues were raised in objections but not fully addressed by the Bankruptcy Court. While many practitioners may have addressed these issues in other, more traditional contexts, they take on a new urgency and perhaps atypical effect in the FWE context, especially when placed next to a divisive merger.

363 Sales.

One issue that could be vetted immediately is the effect of a 363 Sale upon surety bonds. In general, a purchaser of assets under Section 363 of the Bankruptcy Code can buy assets "free and clear of all liens, claims and encumbrances." Some sureties argued that the case law interpreting Section 363 in this manner cannot apply to the surety bonds. Many sureties remained obligated to BOEM under their bonds regardless of what happened to FWE. However, could Newco, as a purchaser of "free and clear" assets, arguably gain the ability to own and

[40] So be on the lookout in future newsletters!

[41] *See* DEL. CODE ANN., tit. 8,§ 252 *et seq*. (West 2017).

[42] *See* TEX. BUS. ORGS. CODE ANN. § 10.001, *et seq*. (West 2015).

operate the deepwater wells without having to provide new financial assurances because BOEM was already protected? Some sureties argued that, by granting Newco "free and clear" protection from the indemnity obligations associated with surety bonds, Newco was getting a free ride under the Plan structure that the court should not condone. While BOEM never stated that Newco did not have to provide its own financial assurances, it remains to be seen how any new financial assurance provided by Newco will affect the bonds provided by the sureties to pre-bankruptcy FWE and the remaining entities under the divisive merger that could now be considered "Predecessors."

The Bankruptcy Court flatly rejected the sureties' interpretation under a strict reading of Section 363. While the Court approved the sale of FWE's leases free and clear of liens, including those created in favor of sureties by virtue of rights of subrogation, it preserved the sureties' rights of contribution, including potential rights of contribution from Predecessor entities which are jointly and severally liable for decommissioning obligations.

This isolated issue is now on appeal and several sureties may test this concept under the various principles of suretyship law, including the effect of the U.S Supreme Court's *Pearlman* opinion and its progeny.[43]

Immediate Impact of the FWE case.

One take away from the FWE case is that we will likely see many more and varied "divisive merger" bankruptcy plans. In any of these situations, valuable assets will be siphoned off for the benefit of secured lenders, while the entities themselves survive (as opposed to truly liquidating) and massive liabilities are pushed into liquidating entities. Some hallmarks of established bankruptcy law—such as "similarly situated creditors are to be treated similarly," or "no lower situated creditors shall receive assets under the Plan until a higher situated creditor is paid in full"—are sure to be stressed.[44] Will these divisive mergers weaken sureties' ability to attack an unfair plan on these grounds? The result in FWE renders these basic principles uncertain.

It has been raised in many circles, both in and outside of bankruptcy, that the entire concept of suretyship in the Gulf of Mexico will come to an end after the FWE case. This is certainly possible. Could the divisive merger statutes also similarly threaten other industries served by sureties? Some may take comfort in the comments from the Bankruptcy Court highlighting that, despite "complaints to the contrary," the Court still sees the role of sureties in the Gulf as a "positive one" because surety bonds still provide financial assurances to many companies that allow for more drilling and cheaper energy prices. Without surety bonds, only the largest and most financially secure companies will be able to explore for oil.

Treatment of executory contracts is now possibly an open issue again. Courts are certainly divided on this issue.[45]

Unfortunately, the success or failure of the confirmed FWE plan may end up having little to do with surety law and the impact of the Bankruptcy Courts' direct rulings. Success may ultimately depend upon the fluctuating price of oil, which will dictate whether the surviving sureties will bear risk on their bonds. For sureties backing the abandoned assets, payment on the risk appears assured. For sureties on the transferred risk to Newco, payment would seem unlikely, but one never knows because any E&P company may now be incentivized to set this whole house of cards up again. For sureties in the

[43] *See Pearlman v. Reliance Ins. Co*., 371 U.S. 132 (1962).

[44] These two principles are also known as the "equal treatment of creditors" test and the Absolute Priority Rule. *See* 11 U.S.C. §§ 1123(a)(4) and 1129(b).

[45] Under Fifth Circuit precedent, applicable in FWE, a contract is executory if "performance remains due to some extent on both sides" and if "at the time of the bankruptcy filing, the failure of either party to complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party." *RPD Holdings, L.L.C v. Tech Pharmacy Servs (In re Provider Meds, L.L.C.)*, 907 F.3d 845, 851 (5th Cir. 2018). But compare the majority view in *In re Evans Prod. Co.*, 91 B.R. 1003, 1005 (Bankr. S.D. Fla. 1988) (A principal's performance obligations under both the bonded obligation as well as the indemnification agreement, including the duty to indemnity and pay premium, to constitute remaining performance obligations within the meaning of an executory contract); with the minority view *In re Falcon V, L.L.C.*, 620 B.R. 256, 264 (Bankr. M.D. La. 2020) (finding that the surety bond is not an executory contract).

middle—needing dwindling assets and higher oil prices to avoid payment—the jury is still out.

Foreshadowing Long-Term Concerns.

On a broader level, one could ask, are the surety-related issues raised in the FWE case limited solely to the oil patch? What about the entire energy industry? Certainly, the regulatory environment for offshore O&G drilling is unique, and the concept of predecessor liability is not regularly available in most states or in other energy industries such as coal and other natural minerals. Is there any applicability of this case to the basic contract surety? What about other types of surety bonds?

One probable result is that the various and expanding merger statutes in several states will be used by crafty debtors to create a divisive merger plan similar to the Plan confirmed by FWE. This concept could have a broad ranging impact on sureties in many industries and will most likely not be limited to O&G or just energy companies. Mass tort and heavy industrial cases seem a likely target for divisive mergers.[46] Will the few protections afforded by some merger statutes be enough for sureties or other general creditors to protect against these efforts? Based upon a review of the Texas and Delaware merger statutes, the answer is probably no, at least not at this time.

In the end, while some legal issues raised by the sureties in FWE were ruled upon by the Bankruptcy Court, both favorably and unfavorably, many others were left unresolved because targeted objections were withdrawn as a result of various settlements and stipulations. There is an unsettling feeling that many of the fundamental surety issues raised in FWE warrant further examination and resolution.

Maybe the FWE case was simply "too big to fail," and these important issues can be vetted again in another forum and under different facts that will not risk the massive environmental impact at play in FWE. Without the backing of the federal government, the FWE Plan would certainly have failed. But would the disputed surety issues have prevailed, regardless of the federal government's support, had more sureties decided to push them? Stay tuned.

[46] One emerging non-bankruptcy case is the attempt by Johnson & Johnson to isolate its talc liabilities using the "Texas Two-Step" similar to FWE, a move that plaintiffs claim violates Missouri's fraudulent transfer statutes.