Meeting Date: 02/26/24
Staff: S. Pemberton

Staff Report 88

PROPOSED ACTION:

Consider supporting SJR 12 (Min), which would urge the President of the United States and the United States Congress to modify bankruptcy rules in the event that an oil and gas lease is liquidated and terminated under the United States Bankruptcy Code, to prioritize plug and abandonment and restoration obligations that would protect the environment over secured creditor claims and to treat the plug and abandonment and lease restoration obligations for debtor held oil and gas leases as nondischargeable obligations.

BACKGROUND AND DISCUSSION:

When Venoco and Rincon Island Limited Partnership filed for bankruptcy in 2017 and 2016, respectively, the Commission became responsible for decommissioning immense and costly oil and gas operations because the operations stemmed from leases issued by the Commission. The Commission had to step in quickly to protect public health and safety and the environment because of the risk of an oil spill or a release of hydrogen sulfide gas. These bankruptcies, the first of their kind in California, demonstrated how one action, outside of the state's control, could singlehandedly erase expensive decommissioning obligations required under the state's leases.

There are two general ways an oil and gas operator files for bankruptcy. One is a Chapter 7 bankruptcy, which means that a trustee is appointed to liquidate nonexempt assets and distribute the proceeds to creditors. The second is a Chapter 11 bankruptcy, which means reorganizing the business and potential resumption of operations, though liquidation is still possible through a Chapter 11 filing. Venoco filed for bankruptcy under Chapter 11 of the Bankruptcy Code in Delaware. Rincon Island Limited Partnership filed for bankruptcy under Chapter 7 of the Bankruptcy Code in Texas. Since then, the Legislature has appropriated nearly two hundred million dollars from the General Fund to the Commission for

decommissioning and other responsibilities that shifted to the Commission after the lessees filed for bankruptcy.

The federal Bankruptcy Code prioritizes repayment to creditors and paying attorney and administrator fees over the performance of lease obligations such as well plug and abandonment, oil platform decommissioning, and most other environmental obligations. Bankruptcy courts may even go so far as to outright excuse a company from environmental clean-up responsibilities. Because of these laws, states often cannot recover money to cover these enormous expenses and have no way to compel a company to perform as they are contracted to do, even after weathering protracted and expensive out-of-state litigation. The financial responsibility falls to the taxpayers.

The federal Bankruptcy Code allowed Venoco to convert the contractual obligations that it agreed to when the state issued it a lease, including the obligation to plug and abandon wells and restore the lands, into an unsecured claim, which meant that the State of California would receive only a fractional payment of its claim, if anything, and only after all secured creditors were paid. Despite active and aggressive attempts by the Commission to pursue Rincon Island Limited Partnership through the bankruptcy process, Rincon Island Limited Partnership dissolved and, by virtue of the United States bankruptcy laws, did not have to honor any of its responsibilities to plug and abandon and decommission the Island, wells and associated oil and gas infrastructure and facilities.

In both bankruptcies, the Commission had to treat the former lessees' plug and abandonment and decommissioning responsibilities as provable monetary claims and work within the confines of a framework intended to protect the debtor's assets at the expense of its creditors. The Commission was able to negotiate agreements with ExxonMobil, the predecessor lessee to Venoco, that require ExxonMobil to decommission platform Holly and related infrastructure and production facilities at its expense (except for the Ellwood Onshore Facility and facilities above the mean high tide line). That negotiation required significant staff work and resulted in agreements by which ExxonMobil took responsibility for obligations that existed when they transferred the leases to Venoco. There was no lessee predecessor for Rincon Island Limited Partnership owing to a prior bankruptcy sale, and the state will incur the entire decommissioning costs.

In 2019, the Supreme Court of Canada held that an oil and gas company that files for bankruptcy has to fulfill its environmental obligations before paying creditors.

The Court ruled that bankruptcy law was meant to protect trustees from having to pay for a bankruptcy estate's environmental claims with their own money. It did not, however, mean that the bankruptcy estate could walk away and avoid its environmental obligations. The Court also ruled that well abandonment costs were not provable claims in a bankruptcy proceeding—that these costs are not debt requirement payments—they are duties to the public and nearby landowners.

There have been nearly 40 bankruptcy filings by oil and gas lessees operating on the Outer Continental Shelf in the past 20 years. More than 260 oil and gas companies have filed for Chapter 11 bankruptcy since 2015. There are 11 remaining actively producing offshore oil and gas leases in California. Despite the state's best efforts, a lessee could, in the future, file for bankruptcy and circumvent their decommissioning responsibilities, shifting hundreds of millions of dollars of well plug and abandonment and decommissioning costs to taxpayers. Decommissioning is a foundational part of the lessee contract—these leases were issued based on the premise that the lessee would restore the land when the operations end. Decommissioning costs are enormous. After dozens of years of extracting oil and gas via a state-issued lease, staff do not want to see a trend where decommissioning expenses and responsibilities are foisted on the state. It is important that bankruptcy laws are not used to circumvent or void decommissioning obligations, leaving taxpayers on the hook.

California has no control over bankruptcy law, but the federal government can change the rules. SJR 12 urges the United States Congress and the President to change the laws to ensure that bankruptcy does not provide a pathway for oil and gas companies to shift decommissioning responsibilities to the state and the public. The Resolution urges the President and Congress to modify bankruptcy rules so that if an oil and gas lessee files for bankruptcy under Chapters 7 and 11, plug and abandonment, restoration obligations, and environmental protections are prioritized over secured creditor claims. The Resolution also urges the President and Congress to modify bankruptcy rules to treat the plug and abandonment and lease restoration obligations for debtor held oil and gas leases as nondischargeable obligations. This would help protect the state and taxpayers from incurring a lessee's decommissioning and environmental restoration obligations and make it less advantageous for a lessee to pursue bankruptcy to shirk decommissioning and restoration obligations.

SJR 12 was introduced on February 13, 2024, and is in the Senate Rules Committee awaiting referral to a policy committee.

EXHIBIT:

A. SJR 12 (Min)

RECOMMENDED ACTION:

It is recommended that the Commission:

Support SJR 12 (Min), which would urge the President of the United States and the United States Congress to modify bankruptcy rules in the event that an oil and gas lease is liquidated and terminated under the United States Bankruptcy Code, to prioritize plug and abandonment and restoration obligations that would protect the environment over secured creditor claims and to treat the plug and abandonment and lease restoration obligations for debtor held oil and gas leases as nondischargeable obligations.

Exhibit A

Senate Joint Resolution **No. 12**

Introduced by Senator Min

February 13, 2024

Senate Joint Resolution No. 12—Relative to oil and gas leases.

LEGISLATIVE COUNSEL'S DIGEST

SJR 12, as introduced, Min. Oil and gas leases: bankruptcy.

This measure would urge the President of the United States and the United States Congress to modify bankruptcy rules to provide, in the event of liquidation and termination of oil and gas leases under the United States Bankruptcy Code, that priority is given to plug and abandonment and restoration obligations, to protect the environment, over all secured creditor claims.

Fiscal committee: no.

WHEREAS, In 2016, Rincon Island Limited Partnership, a lessee of state oil and gas leases offshore of the County of Ventura, filed for bankruptcy in Texas, and in 2017, quitclaimed their three leases to the state, deliberately ignoring their contractual and statutory obligations to plug and abandon 75 oil and gas wells and decommission two oil production facilities located on public lands; and

WHEREAS, In 2017, Venoco, LLC, a lessee of state oil and gas leases offshore of the County of Santa Barbara, surrendered its leases to the state and then declared bankruptcy in Delaware, without undertaking its legal obligation to plug 32 wells across the leases or to decommission Platform Holly and the associated facilities; and

WHEREAS, At the time of the bankruptcies, the leases operated by Rincon Island Limited Partnership were out of compliance with

the lease requirements, creating greater risk of an uncontrolled release of oil or gas into the marine environment, and rather than bring the leases into compliance, as they were legally required to do, and as California governmental agencies were pressing them to do, Rincon Island Limited Partnership chose bankruptcy as a way to avoid the costs of compliance and decommissioning; and

WHEREAS, The leases operated by Venoco, LLC were ultimately deserted on the grounds that the company could no longer afford to operate, risking releases of hydrogen sulfide gas and oil from wells located on Platform Holly; and

WHEREAS, In both instances, the State of California was forced to use its police powers to enter and to manage the abatement of the deserted oil and gas facilities to ensure protection of human health and safety and the environment; and

WHEREAS, The obligations under the leases for both Rincon Island Limited Partnership and Venoco, LLC required each to permanently and safely plug and abandon all wells and restore public property to its natural condition at the lessee's expense, an obligation now forced upon the State of California because of bankruptcy protections provided for in federal law, costing taxpayers more than $150,000,000; and

WHEREAS, The State of California has statutory obligations, enforced by the Department of Conservation's California Geologic Energy Management Division, for operators to permanently plug and abandon oil wells and decommission oil and gas infrastructure at the end of its useful life; and

WHEREAS, By quitclaiming its leases before filing bankruptcy, Venoco, LLC was allowed to convert the contractual obligations that it agreed to when it became a lessee of the state, including the obligation to plug wells and restore public lands, into an unsecured claim, ensuring that the State of California would receive only a fractional payment of its estimated claim and only after all secured creditors were paid; and

WHEREAS, Despite active and aggressive attempts by the state to pursue Rincon Island Limited Partnership through the bankruptcy process, including traveling to Texas, where Rincon Island Limited Partnership filed bankruptcy, and retention of outside counsel specializing in these matters, Rincon Island Limited Partnership was legally able to dissolve and largely avoid its

responsibilities to plug and abandon and decommission by virtue of the United States' debtor-friendly bankruptcy laws; and

WHEREAS, Despite active participation in each bankruptcy, the State of California will likely receive little to no compensation from the debtor's estates for the public monies spent to safely manage and abate the facilities deserted by the debtors; and

WHEREAS, Beyond these two cases, there are over 35,000 oil wells in California categorized as idle, with many owned by companies that could seek bankruptcy protection, requiring future plug and abandonment by the State of California, without recompense; and

WHEREAS, The risk remains that oil and gas companies could, in the future, employ the strategy of filing bankruptcy to circumvent their decommissioning responsibilities, thereby shifting the costs of remediation and abatement to California taxpayers; and

WHEREAS, The people of California believe it is important that the federal government ensure that bankruptcy does not provide a default pathway for oil and gas companies, or their equity owners, to shift critical environmental obligations to decommission oil and gas infrastructure to the public or to otherwise publicly subsidize the operations of these private companies; and

WHEREAS, On January 31, 2019, the Supreme Court of Canada held that, consistent with an order of the Alberta State regulator, a bankruptcy debtor had to comply with end-of-life abandonment obligations prior to any distribution to creditors (Orphan Well Association v. Grant Thornton Ltd. (2019) SCC 5); now, therefore, be it

Resolved by the Senate and the Assembly of the State of California, jointly, That the Legislature of the State of California respectfully urges the President of the United States and the United States Congress to modify bankruptcy rules to treat the plug and abandonment and lease restoration obligations for debtor held oil and gas leases, quitclaimed or accepted, as nondischargeable obligations; and be it further

Resolved, That the Legislature of the State of California respectfully urges the President of the United States and the United States Congress to modify bankruptcy rules to provide, in the event of liquidation and termination of oil and gas leases under Chapters 7 and 11 of the United States Bankruptcy Code (11 U.S.C. Sec.

101 et seq.), that priority is given to plug and abandonment and restoration obligations, to protect the environment, over all secured creditor claims; and be it further

Resolved, That the Secretary of the Senate transmit copies of this resolution to the President and Vice President of the United States, the Speaker of the House of Representatives, the Majority Leader of the Senate, and each Senator and Representative from California in the Congress of the United States, and to the author for appropriate distribution.

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