

Why BP Will Not Go Bankrupt

Anthony M. Sabino and Michael A. Sabino

The ongoing crisis in the Gulf of Mexico (GoM) rightfully demands our full attention, not just as those interested in the industry, not just as businesspeople and attorneys, but also as U.S. citizens. Here we have BP, notably the largest onshore producer of natural gas in the United States, at the eye of the storm laboring mightily to stem this disaster and, once it completes that herculean task, remediating the resulting ecological and economic crisis. And all the while BP is under fire from the White House, Congress, politicians of every stripe, and, rightfully so, those out of work, out of business, or suffering for whatever reason from this catastrophe.

We face a somewhat daunting task ourselves—to provide a cogent and legally sound analysis of two of the issues of paramount importance to this readership: BP’s offshore leases and, undoubtedly more terrifying, a possible bankruptcy filing by BP. For the record, we have endeavored to depoliticize an incredibly political controversy. We freely admit that we do not have all the answers, but we hope to provide some illumination that might foster

greater understanding and—who knows?—eventually answers that solve more problems than they create. Now we go into the breach, dear friends.

PROUD TO BE A U.S. CITIZEN

Of course we are proud to be U.S. citizens, and we’re sure you are, too. A good reason for that today is that in the United States, a written contract is a written contract. It has to be respected, and its terms honored. That includes contracts entered into with the federal government. Unlike some lawless dictatorships like Venezuela, the U.S. government has to live up to its contractual commitments like anyone else. And BP’s significant offshore leases and other accords with the federal government and its constituent agencies very much fall within that category of protection.

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Certainly, we are not privy to the specific contractual language found in BP’s leases, as entered into with the Minerals Management Service (MMS), a bureau of the Department of the Interior specifically tasked with apportioning leasehold rights to extract precious resources such as natural gas and oil from offshore sources such as the GoM. But our experience in this area tells us that while no doubt the government has one or more “outs” that would permit the abrogation of such accords, there is no busi-

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ness equivalent to a “moral turpitude” clause that would give the government the unfettered ability to tear up an offshore lease simply because they were angry at BP. To the contrary, any such contractual right to revocation or even modification would be spelled out, most likely in great detail, and the contractual text would have to be followed strictly in order for any action to be effective.

While not conclusive, a cursory review of the current standard oil and gas lease, Form MMS-2005, reveals it is a rather prosaic document, remarkable for its brevity and “plain vanilla” stipulations. Indeed, only Section 13 therein, “Suspension and Cancellation,” caught our eye as clearly reserving to the government the right to terminate the accord, *but* significantly postulating in the same breath that “compensation shall be paid” as provided by law.¹

More to the point, any capricious action by the government would be subject to review in a court of law, just as with any ordinary contract. Indeed, this exemplifies one of the unsung marvels of our U.S. system, in that any unjustifiable action by one branch of government, here a potentially arbitrary and presumptuous executive branch, could be deterred or forbidden outright after a hearing before that coequal branch of government, the judiciary. In short, the courts get the last word.

As to which court, the Tucker Act invests the Court of Federal Claims with jurisdiction over an action claiming the breach of any express or implied contract with the United States.² Just as with ordinary transactions, if you contend that the federal government broke its accord with you, you may sue for money damages in the Court of Federal Claims.

Notably, this process implicates one of our most fundamental rights, that of due process, a constitutional protection even the mighty federal government must yield to. In this regard, BP is like everybody else: it gets its day in court if the federal government breaches its contracts. That right alone should be enough to give any bureaucracy pause before it embarks on a contract-breaching rampage.

Suing the federal government for breach of contract is not new. Recall the savings and loan (S&L) crisis over 20 years ago. To avert calamity, the federal government entered into

contracts to assist solvent S&Ls in taking over bankrupt institutions. After a sea change in Washington, Congress abrogated those accords with a new law commonly known as FIRREA, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.³ In sum, the government broke its contracts. Also in sum, the government was sued by the aggrieved counterparties, and the feds lost, in a still evolving line of cases commonly known as *Winstar*.⁴

Certainly, the *Winstar* cases do not land on all fours with the BP offshore lease scenario before us now, but the essential points are encouraging—to wit, if you have a contract with the federal government, you might not be able to stop them from breaking the contract, but you can sue and recover damages for the breach. We believe it is reasonable to believe that the sensible folks down in Washington will be mindful of these precedents, and hesitate to recommend a wholesale disregard of BP’s standing leases, for reasons of the penalties that will no doubt ensue.

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CHAPTER 11: UNREALISTIC AND HERE IS WHY

While refusing to even discuss a bankruptcy filing by BP would be intellectual dishonesty, our frank assessment is that it is a very remote possibility. Before explaining why, let us lay out the groundwork of the broad contours of the bankruptcy process, both in general terms and specific as to BP.

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Since the early 1980s, bankruptcy has become a viable option for companies in difficulty. It no longer bears the stigma of abject failure as it did in decades past, and is openly discussed in

corporate boardrooms. Moreover, since the advent of the modern Bankruptcy Code in 1978, a potential filer enjoys great latitude as to why it files (outmoded tests of having to prove insolvency having been discarded, for instance) and where it files (absurdly loose standards let the debtor dictate the bankruptcy court in which it files, as evidenced by the plethora of Chapter 11 filings in the debtor-friendly confines of Delaware). Relating this to the matter at hand, the point to be made is that BP can pick when and where it files for bankruptcy anytime and anyplace, if BP so chooses.

It bears scant mention that any filing would be for Chapter 11, the reorganization chapter, whose avowed purpose is to allow a troubled entity to rehabilitate itself; in simple terms, take a sick company and heal it. That convalescence takes place under the stout umbrella of bankruptcy court protection. However, a Chapter 11 filing does *not* mean the ouster of current management nor the appointment of a “trustee” (in sum, a legal guardian put in place as a kind of “super CEO” by the bankruptcy judge). The law explicitly allows management to stay in place, unless just cause is given for its removal, and, most of all, the company continues in possession of its assets and operating its business.⁵

Salutary effects of a Chapter 11 filing include the immediate halt of all litigation against the company wherever it exists or is contemplated,⁶ the centralization of all claims before the bankruptcy court where the case is pending, and the sorting out of all those claims, large or small, in that forum.⁷

Admittedly, we have witnessed Chapter 11 as a mechanism to reorganize a host of American corporations, across a broad spectrum of businesses. Why should BP be different?

WHY A BP CHAPTER 11 MAKES NO SENSE

Our whole point is that BP *is vastly different*, and thus it makes absolutely no sense for BP to file for bankruptcy. An examination of history and the current situation proves our point convincingly, as follows.

History—we need to learn from history, and our closest example is the Exxon Valdez disaster over 20 years ago. Surely the GoM crisis has greatly exceeded the Alaskan oil spill, and tragically so. Yet remember that Exxon never even

came close to filing for bankruptcy, and for reasons applicable to BP today. As horrific as both the current blowout is and the Valdez was, each was an isolated event, not subject to repetition. Like lightning, neither will strike twice.

And please do not compare BP with Texaco. The Texaco Chapter 11 of the late 1980s was, at bottom, a purely legal maneuver to forestall and settle out a multibillion-dollar legal judgment stemming from Texaco’s contested acquisition of Getty Oil. In both its origins and its goals, Texaco is not comparable to BP’s situation today.

Next, Exxon did not file for bankruptcy because it was far better able to deal with the crisis and its aftermath by keeping the doors open and doing what it did best—generate cash. Chapter 11 comes with a terrible cost of court and creditor interference, legal fees, and distractions from business. Exxon knew, as BP does now, that by avoiding the constraints of the bankruptcy process it can continue to do business and remain the gargantuan cash cow that it is.

The urgent need to file bankruptcy, if in fact it ever existed, was eradicated from the first day BP and the White House announced the agreement to create a \$20 billion compensation fund, and have same administered by an independent administrator. First, the mere creation of such a fund proves that BP has the resources to do so. No doubt, the pool of funds will be sourced from BP’s self-insurance, cash flow, and savings from suspension of its dividend for the near term. But most significant, *future* funding will undoubtedly come from BP operations, underscoring the imperative to stay out of bankruptcy. On a related point, the compensation trustee, Kenneth Feinberg, is a proven administrator who brings a vast and unique skill set from overseeing the 9/11 victims’ compensation fund. The obvious benefit to BP is that all it has to do is to put money in: sorting out the claims and making payments is left to Trustee Feinberg and his staff. And more than anything, funneling injured parties to the fund keeps them (and BP) out of court.

That last point leads to our next reason why bankruptcy makes no sense for BP. A major reason why Chapter 11 exists is to “adjust the debtor-creditor relationship.”⁸ With the compensation fund in place, BP achieves a paramount goal of Chapter 11—but without filing for bankruptcy.

Notably, a filing by BP would introduce a potentially dangerous wild card—a bankruptcy judge—into an already overcrowded and hostile arena. For reason of constitutional limitations, bankruptcy judges have severely circumscribed jurisdiction. These limits invite controversy and appeals, an appalling hindrance to the process. And no one wants to chance that a bankruptcy judge exceeded his or her power on issues of this magnitude. Finally, everybody here—BP, the president, and on and on—has an agenda. These power players abhor the thought of having to deal with, let alone answer to, such a minor potentate as a bankruptcy judge. For their own reasons, the consensus is no doubt to steer clear of a meddling bankruptcy judge.

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Our final reason for BP not filing for bankruptcy is again historical—but this time recent, if not current, history. We refer to the GM and Chrysler Chapter 11s, in our humble opinion unmitigated disasters that, as time will bear out, have done inestimable damage to the conduct of business in this country. First, both beleaguered carmakers were ramrodded through bankruptcy, with hastily constructed asset sales. Due to luck more than anything, these abominations survived legal challenges.

Second, each carmaker's Chapter 11 smashed to pieces one of our most hallowed laws of insolvency cases: the absolute priority rule. To be precise, claims against a debtor are prioritized with unswerving allegiance to the seniority of the debt and its underlying collateral. Hence, the modern iteration of thousands of years of secured lending—that is, secured creditors stay secured by having the exclusive right to be paid out of the collateral pledged to them (and to the exclusion of competing creditors), and in the order of senior debt holders first (again, to the exclusion of junior creditors, i.e., the more junior you are, the further to the back of the line you go).

The GM and Chrysler bankruptcies obliterated these very cornerstones of business lending

in this country (as well as contract law itself, the very foundation of our economy), and it is too early to tell the long-lasting damage this travesty will do to the capital markets. Suffice it to say that lending institutions, already beleaguered by their own missteps this decade, are beside themselves with fear, and would view another sundering of their rights as catastrophic. Even the government proponents of the automaker Chapter 11s know it is too soon to chance such a peradventure again, this time with BP's lenders. And the guaranteed chaos in store for all other interested parties means a unity of purpose—do not try it again.

Thus, nobody wants or will permit a BP Chapter 11.

CHAPTER 11? WHAT ABOUT CHAPTER 15?

Our analysis of bankruptcy options—or non-options, as you have seen—would be incomplete unless we briefly address Chapter 15. And just what is Chapter 15? In short, Chapter 15 is the newest provision of the Bankruptcy Code, having been tacked on with the last round of bankruptcy law reform in 2005. Pertinent here, it permits the filing in a U.S. court of an ancillary proceeding, said filing to be of assistance and subsidiary to the filing of an insolvency case commenced in another nation.⁹ The foreign bankruptcy would be the insolvency proceeding of a foreign corporation, a matter sensibly left to the courts and laws of its home nation. The U.S. involvement comes in because the foreign company has U.S.-based operations and/or subsidiaries. Thus, the “assistance” aspect of Chapter 15, as it allows a U.S. bankruptcy judge to, in essence, lend a helping hand to the foreign bankruptcy court in preserving and administering the U.S. end of the foreign corporation's business.

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Do obstacles exist to a Chapter 15 filing by BP, and are they significant? The answer to both queries is a resounding “yes.” As for the former, a Chapter 15 cannot exist in a vacuum. First, a Chapter 15 can only follow, if at all, the com-

mencement of an insolvency case in a foreign court. No matter the size of an entity's U.S. operations—and in BP's case, they are enormous—the cart cannot come before the horse. Chapter 15 is nonexistent unless and until a bankruptcy case is filed in a foreign forum.

Second, Chapter 15 is fairly novel as far as laws go. At only five years of age, it is still in a nascent state, its boundaries largely untested. It would be a fool's errand to experiment with the Bankruptcy Code's newest chapter on the behemoth that a BP Chapter 15 would be.

Finally, it is a well-known fact that BP stands for “British Petroleum,” accent (no pun intended) on “British.” The entity is organized as the traditional English PLC, or public limited company, the U.K. analogue to the standard U.S. corporation or inc. Notably, our British cousins use the term *company* as we in the United States use the term *corporation*, and U.K. businesses are organized in quite similar form by corporate law known as the English “Companies Act,” the parallel to our state laws of incorporation.

Yet here is the most telling point: English insolvency law is vastly different from the U.S. Bankruptcy Code, and in some alarming ways. What is most radical to us in the United States is that the British law mandates the appointment of a trustee or receiver for the company, and utterly tosses out existing management. Next, most unlike our methods, where it is typically an attorney who assumes the role of a court-appointed trustee, English law strongly prefers a “chartered” accountant, the British twin of our certified public accountants. Said chartered accountant is typically from a major English accountancy firm (or the U.K. affiliate of one of the U.S. Big Four accounting firms). Most unsporting, as our English cousins would say. In short, appointing an accountant and not a lawyer is anathema to the U.S. way of thinking about bankruptcy proceedings.

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All of this adds up to one result, again in our humble opinion: the likelihood of a Chapter 15

filing by BP is unlikely in the extreme. A Chapter 15 filing domestically is possible only if BP files overseas, and thus the discussion ends at that point. As for an English-based insolvency, we do not see that happening, given the wide differences in how insolvency cases are adjudicated in the United Kingdom. Such severe disparities would compel the U.S. voices within BP to cry out against such a step. And they will not be alone, because we cannot foresee any scenario where the U.S. government will allow BP to make such a move, if for no other reason than to preserve, in U.S. hands, the compromise so recently arrived at on establishing the much-desired compensation fund.

NIGHTMARES CANNOT HURT YOU

Again, we are not prescient: anything is possible. But we do not foresee such irrevocably destructive steps as the abrogation of BP's offshore leases and similar agreements with the federal government, nor do we see a Chapter 11 in BP's future. Always at the risk of oversimplification, we see the problems and the solutions as clear as these: the GoM leak has to be plugged, the cleanup must be done, and somebody has to pay for it. BP has to be viable to accomplish all this, and blasting it out of existence by decimating its invaluable lease holdings and/or persecuting it via a tortuous and unproductive bankruptcy process makes no sense at all.

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We hope that those in control see it our way. ☪

NOTES

1. See Section 13, Form MMS-2005 (October 2009), “Oil and Gas Lease of Submerged Lands Under the Outer Continental Shelf Lands Act,” available on the MMS Web site.
2. See 28 U.S.C. § 1491(a)(1).
3. Codified at scattered sections of titles 12 (banking) and 26 (Internal Revenue Code).
4. See *U.S. v. Winstar Corp.*, 518 U.S. 839 (1996).
5. 11 U.S.C. § 1107 and § 1108.
6. 11 U.S.C. § 362.
7. 11 U.S.C. § 501.
8. 28 U.S.C. § 157(b)(2)(O).
9. See 11 U.S.C. § 1501.

argue that MISO failed to comply with FERC's February 2009 Order because MISO failed to address the impact of congestion on capacity resource deliverability. Therefore, FirstEnergy and Duke requested that FERC reject MISO's August filing.

FirstEnergy and Duke both assert that MISO failed to establish a more permanent approach to determining the locational value of generation on a market basis. FirstEnergy recommends that MISO require identification and commitment of capacity resources on a 12-month rolling basis with capacity resources required to offer into the day-ahead market as a starting point. FirstEnergy also recommended that MISO establish expanded special supply provisions to support the continued operation of generation in import-constrained areas.

On June 8, 2010, FERC rejected the MISO August compliance filing, asserting that MISO did not identify a permanent approach to address congestion that limits deliverability in the capacity market. In the June Order, FERC asserts its February Order directed MISO to incorporate locational pricing or locational rules into the capacity construct. FERC did not agree with MISO that its loss of load study process and regional expansion plan were adequate to ensure deliverability and instead preferred the use of locational price signals to incent generation retention and expansion in areas where imports might be limited. Therefore, MISO has begun to reassess its capacity construct through its Supply Adequacy Working Group and through bilateral discussion with state regulatory commissions, many of which have supported MISO's current approach and remain reluctant to agree with the need for locational pricing or rules.

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MISO May Need New Rules to Avoid Further Transfers Out

Nonetheless, MISO has received its Order from FERC to implement some locational pricing mechanisms or rules. A permanent locational capacity construct may also be needed to combat the attrition exemplified by the FirstEnergy and Duke

migration from MISO to PJM that is presumably the result of greater expected revenues provided to these companies through their generation assets' participation in the centralized RPM construct relative to MISO's bilateral market.

These companies no longer benefit from the cost-recovery certainty provided by traditional regulation, and retail choice threatens to reduce the provider-of-last-resort customer base. The RPM auction is generally perceived as providing greater access to capacity customers relative to MISO's bilateral construct given the majority of MISO members are vertically integrated and rates to customers will be minimized when distribution utilities contract with their regulated generators. It is also worth noting that Ameren, another of MISO's largest members, also submitted comments requesting that FERC reject MISO's August filing.

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NOTES

1. In the Federal Energy Regulatory Commission proceedings, FirstEnergy is referred to as ATSI, or American Transmission System, Inc., because this is the name of First Energy's affiliated transmission company, and it is transmission companies who constitute the primary membership in the regional transmission organizations regulated by FERC.
2. Supply resources can be generally thought of as power-generating stations, but also includes demand-side resources in the RPM auction.
3. The July 2009 Voluntary Capacity Auction cleared at \$10,000 per MW/month. June 2009 cleared at \$50 per MW/month, and June, July, and August 2010 cleared at \$5, \$10, and \$10 per MW/month, respectively. All other months beginning August 2009 settled for \$1 or less per MW/month.
4. FirstEnergy's request for realignment was accepted subject to some compliance issues on December 17, 2009, in Docket ER09-1589-000.
5. There were two Orders on Rehearing and Compliance issued in FERC Docket ER08-394 on February 19, 2009. The Order noted here refers to 126 FERC ¶ 61,144 in Sub Docket 006 and 008.
6. A loss of load expectation study is a probabilistic analysis that simulates successive component failures to determine a capacity level needed to ensure a one-day in ten-year reliability standard.
7. FirstEnergy submitted these comments to FERC on September 9, 2009, 40 days after its intention to withdraw was publicly announced and 23 days after FirstEnergy filed with FERC to terminate its voluntary membership in MISO.