BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the matter of the application of Quito, Inc. ("Operator") for an operator's license renewal.	Docket No: 22-CONS-3115-CMSC CONSERVATION DIVISION License No: 33594

REPLY BRIEF OF QUITO, INC.

Quito, Inc. submits its Reply Brief to the Response Brief of Commission Staff filed on April 15, 2022, pursuant to the Commission's Order on Briefing and Requiring Staff Report and Further Investigation.

At issue is the impact of discharge of Mark W. McCann, a natural person, under the United States Bankruptcy Code. How does his discharge bear upon the liability of McC Oil Company, Inc. (hereafter "McC"), to comply with state statutes and the Commission's rules and regulations concerning the four (4) unplugged wells remaining on McC's expired operator's license at the time of Mr. McCann's discharge in Bankruptcy? Quito, Inc. asserts that its denial of license renewal is based solely upon a debt of Mark W. McCann that was discharged or was dischargeable under the Bankruptcy Act.

I. Dissolution of McC Oil Company, Inc.

K.S.A. 17-6804(c), in effect on December 30, 1998, required no separate consent in writing to a dissolution; the filing of the Consent to Dissolution in the office of the

Secretary of State was sufficient, in and of itself, to cause the dissolution of McC.

K.S.A. 17-6810, in effect on December 30, 1998, provided as follows:

> "The trustees or receivers of a dissolved corporation, after payment of all allowances, expenses and costs, and the satisfaction of all special and general liens upon the funds of the corporation to the extent of their lawful priority, shall pay the other debts due from the corporation, if the funds in their hands shall be sufficient therefor, and if not, they shall distribute the same ratably among all the creditors who shall prove their debts in the manner that shall be directed by an order or decree of the court for that purpose. If there shall be any balance remaining after the payment of the debts and necessary expenses, they shall distribute and pay the same to those who shall be justly entitled thereto, as having been stockholders of the corporation or their legal representatives."

K.S.A. 17-6810 has been substantially amended since 1998. In substance, that statute now allows a "dissolved corporation or successor entity" to follow the procedures set out in K.S.A 17-6808a. K.S.A. 17-6808a did not exist in 1998, and was only adopted and effective from and after July 1, 2016. Briefly, K.S.A 17-6808a establishes a procedure for a dissolved corporation or successor entity to give notice of the dissolution to the corporation's creditors; pay or dispute creditor claims, and ultimately distribute to the dissolved corporation's stockholders any remaining assets.

In 1998, the current statutory procedures set forth in K.S.A 17-6810 and 17-6808a did not exist. There is no suggestion that trustees or receivers of McC were ever appointed following its dissolution, or that any assets or property of McC passed into the hands of trustees or receivers of McC, and ultimately, that any such trustees or

receivers payed over to Mark W. McCann as the sole stockholder of McC any net balance remaining after the payment of debts and necessary expenses.

In this case, the four wells remaining on McC's expired operator's license were enhanced oil recovery injection wells. K.A.R. 82-3-403(g)(1)(B) requires that an injection well be designed to protect fresh and useable water. K.A.R. 82-3-405 requires the casing to be cemented so that damage will not be caused to hydrocarbon sources or fresh and usable water resources. It is submitted that the surface casing and injection casing in each of the four wells was cemented from the surface to the total depth of each well and that neither the surface casing nor the well casing could have or now could be economically removed from the wellbore. Even though the surface casing and well casing may be classified for ad valorem personal property taxes as personal property, it has no salvage value.

Injection into the four enhanced oil recovery wells may have occurred through tubing. It is submitted that after incurring costs to pull the tubing, transport it to a yard for resale, pressure test to determine if the tubing has value in another oil and gas well application, or has value as structural pipe only, and also test to determine if the tubing has been contaminated by low-level radioactivity, the net salvage value of any tubing and associated appurtenances in any of the four enhanced oil recovery injection wells in this case would be nominal. In any event, there is no evidence indicating that McC's

sole shareholder, Mark W. McCann, received any assets or proceeds of sale of assets from McC following its dissolution.

Certainly, now some 23 plus years after abandonment of the four wells on McC's operator's license, there would appear to be substantial question as to the ownership of any abandoned tubing and appurtenances in place associated with the four enhanced recovery wells in this case. See: Pratt v. Gerstner, 18 Kan. 148, 360 P.2d 1101 (1961).

As noted in In Re: Roedemeier, 2006 Bankr. LEXIS 1132 (Bankr. D. Kan. June 22, 2006), forfeiture of a corporation's articles does not dissolve the corporation, and in that case the corporation's dental equipment did not revert to the debtor, who was the corporation's sole shareholder. In Roedemeier, dental equipment owned by the corporation whose articles had been forfeited remained property of the forfeited corporation. Citing K.S.A. 17-6807 as the statute which governs the windup of affairs following dissolution or forfeiture of a corporation, the Court held that forfeiture does not cause the corporation's property to revert to the stockholders. Although forfeiture and dissolution are distinct concepts in the law, for property ownership purposes, both are governed by the same statute in this state - K.S.A. 17-6807. Under K.S.A. 17-6806, the District Court would have authority to appoint a receiver of a dissolved corporation (here McC) to take charge of its property, to collect debts on property due to it, to prosecute actions on behalf of the dissolved corporation, to pay the dissolved

corporation's debts, and ultimately to distribute any remaining property to its shareholders. As no trustees or receivers have been appointed for McC, and there is no suggestion that the procedures set forth in K.S.A. 17-6807 or other parts of the Kansas Corporation Code have been followed to windup the affairs of McC, there can be little doubt that the property of McC did not magically devolve upon its sole shareholder. See also: Doniphan County v. Miller, 26 Kan. App. 2d 669, 993 P.2d 648 (1999), holding that a forfeited corporation remained the repository of title for real property.

II. Dischargeability of Debt

11 U.S.C. §101(5) defines a claim as the:

> "(A) right of payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secure, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgement, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured."

In the context of compliance with existing statutory duties to comply with laws relating to environmental pollution, existing case law appears to distinguish between: (A) claims for the payment of money, and (B) obligations to stop or ameliorate ongoing pollution.

In Chateaugay Corporation v. LTV, 944 Fed. 2d 997, the Court held that pre-petition conduct fairly giving rise to a contingent claim of the EPA under CERCLA was

dischargeable; thus the Court limited dischargeability in that case to pre-petition releases or threatened releases of hazardous substances.

Most of the cases addressing the issue of dischargeability arise in the context of a bankrupt debtor's plan for reorganization. If an oil and gas lease is treated as an executory contract, a trustee, receiver or manager appointed in the bankruptcy action, including a debtor in possession, may seek to abandon the lease if substantial plugging or other remediation costs are associated with the leasehold estate. Midatlantic v. New Jersey Department of Environmental Protection, 474 U.S. 494, 106 Sup. Ct. 755 (1986) addressed applicability of §959(b) of the Bankruptcy Code which requires the trustee to manage and operate the property of the bankruptcy estate according to the requirements of the valid laws of the State in which such property is situated. Relying on that section, the Court in Midatlantic determined that a bankruptcy trustee may not abandoned property in contravention of state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards. In In Re: HLS Energy Co., Inc., 151 Fed. 3d, 434 (5th Cir. 1998), the prohibition of abandonment of environmental obligations was recognized, but limited to post-petition liabilities.

In summary, it appears that liabilities for plugging and abandonment arising pre-petition are dischargeable in a bankruptcy reorganization, but post-petition liabilities are not dischargeable.

Here, McC has not sought relief under the Bankruptcy Act. No bankruptcy trustee has sought to abandon the property of McC. In the present case, the issue may be more narrowly defined: to the extent that Mark W. McCann was individually liable for the statutory or regulatory compliance duties of McC, as its sole shareholder, as a predecessor to McC, or in any other manner, was any such liability discharged or dischargeable in bankruptcy?

Although the Response Brief of Commission Staff appears to analyze the dischargeability question as a common issue applicable to both Mark W. McCann individually and McC, that approach blurs the separation of the entities and the distinct legal duties to which each was subject.

McC has never sought discharge under the Bankruptcy Code. Thus, any order that directs it to end or ameliorate continuing pollution, and that is therefore not a "claim" that is non-dischargeable in bankruptcy is effectively academic. Such obligation is not affected by any bankruptcy proceeding. Although enforceability of any order to cease or ameliorate ongoing pollution directed to McC may be problematic, or involve separate legal hurdles, bankruptcy is not a bar to any such order.

Turning then to the dischargeability of any liability to which Mark W. McCann was subject, it is first noted that no order has been directed to Mr. McCann to enjoin him personally from any environmental pollution claim. As provided in K.A.R. 82-3-111, within 90 days after operations cease on any well drilled for the purpose of exploration,

discovery, service, or production of oil, gas, or other minerals, the operator shall either plug the well or file an application requesting temporary abandonment authority. In the present case, McC's operator's license expired on March 30, 1999. It would appear axiomatic that not later than June 30, 1999, McC was required to either plug the four wells or obtain temporary abandonment authority. Since neither occurred, the Commission had apparent authority to assert a claim against Mark W. McCann's bankruptcy estate for the cost to plug the wells prior to his discharge on September 16, 1999. As noted above, Commission Staff in its Response Brief asserts this liability existed due to the dissolution of McC, and devolution of its assets and liabilities to Mr. McCann as McC's sole shareholder. Mr. McCann may also have been a predecessor in title to the working interest in some of the leases upon which the four (4) wells are located, and therefore had potential liability exposure for well plugging under K.S.A. 55-179. There may be other legal theories upon which liability for payment or equitable remedies could have been asserted against Mr. McCann personally for the regulatory compliance duties of McC, under which the Commission would have authority to assert a right of payment against Mr. McCann. While such claim may have been contingent, unmatured, or disputed, it would nevertheless involve an obligation existing at the time of Mr. McCann's bankruptcy which would have been discharged under the Bankruptcy Code.

Conclusion

Mark W. McCann was personally discharged from any debt or equitable remedy for breach of performance by McC giving rise to a right of payment which the Commission could have asserted against him in his prior bankruptcy. In an effort to circumvent 11 U.S.C. §525(a), Commission Staff now seeks to deny renewal of the operator's license of Quito, Inc. Recognizing the apparent inability to enforce the Commission's Orders directing McC to plug the four abandoned wells, Commission Staff seeks to impose this obligation upon Mark W. McCann personally. That right of payment has previously been discharged in bankruptcy. Denial of Quito's license renewal is expressly prohibited by the Bankruptcy Act. The totality of the circumstances lead to the only appropriate and lawful resolution of this dispute - renewal of Quito's operator's license.

SUBMITTED BY:

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CERTIFICATE OF SERVICE

22-CONS-3115-CMSC

I, the undersigned, certify that a true copy of the attached Reply Brief of Quito, Inc. has been served to the following by means of electronic service on April 28, 2022.

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