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 Nos: 22-CONS-3115-CMSC CONSERVATION DIVISION License No: 33594

OPENING BRIEF OF QUITO, INC.

Pursuant to the Order on Briefing, and Requiring Staff Report and Further Investigation issued by the Commission on March 8, 2022, Operator, Quito, Inc., submits its Opening Brief, addressing the provision of the federal bankruptcy code which the license denial order violates.

11 U.S.C.S. §525(a) provides in relevant part:

> "...[A] governmental unit may not deny, revoke, suspend or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against...a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act." (internal cites omitted)

Quito, Inc. submits that the refusal of Commission Staff to renew the Operator's license of Quito, Inc. is in violation of §525(a) above.

I. Purpose of 11 U.S.C.S. §525.

The primary purpose of 11 U.S.C.S. §525 is to protect the debtor's means of earning a living or pursuing a livelihood. A governmental unit may not discriminate against an individual so as to frustrate the fresh-start policies of the Bankruptcy Code simply because an individual has filed a petition under Title 11. Whenever state regulations frustrate the underlying purposes of the Code, they are violative of 11 U.S.C.S. §525, and may not be enforced against the debtor. In Re: Elsinore Shore Associates, 66 B.R. 708, 15 Bankr. Ct. Dec. (LRP) 216 (Bankr. D.N.J. 1986).

The following illustrative cases interpreting 11 U.S.C.S. §525 deal with a bankrupt debtor's right to a license.

While operating an uninsured motor vehicle, the debtor and his wife were involved in an accident. They were sued in State Court and confessed judgement. They then filed petitions in bankruptcy, listed this judgment among their debts, and the bankruptcy court discharged the husband and wife from all of their debts. Arizona's Motor Vehicle Safety Responsibility Statute provided that a judgment against a motorist which remained unsatisfied for 60 days was a ground for suspending the motorist's license and registration, even if the motorist received a discharge in bankruptcy. In determining Arizona's statute unconstitutional, the Supreme Court held that state statutes which would frustrate the full effectiveness of federal law are invalidated by the Supremacy Clause. Perez v. Campbell, 402 US 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233

(1971).

In FCC v. NextWave Pers. Communs., Inc., 537 U.S. 293, 123 S. Ct. 832, 154 L. Ed. 2d 863 (2003), cancellation of broadband spectrum licenses by the FCC based upon the debtor's failure to make required installment payments was held a violation of 11 U.S.C.S. §525(a), because the revocations of licenses were based solely on nonpayment of regulatory payment obligations which were debts subject to discharge in bankruptcy. See also: Jacobs v. Oklahoma, 149 B.R. 983, 28 Collier Bankr. Cas. 2d (M.B.) 556 (Bankr. N.D. Okla. 1993). Revocation of a debtor's insurance agent's license for nonpayment of a discharged debt to an insurance company for advanced commissions the debtor had never earned violated 11 U.S.C.S. §525, and also 11 U.S.C.S. §524(a)(2). In Jacobs, the Court noted that the insurance company and its receiver were solely interested in collecting the debt and the commissioner's own notice to show cause contained no allegation of any fact such as impropriety, coercion, fraud, misappropriation, dishonesty, incompetence, breach of trust, financial responsibility, or misconduct, as a basis for revocation of the license.

Jacobs can be contrasted with In re: National Cattle Congress, 179 B.R. 588, 33 Collier Bankr. Cas. 2d (MB) 401 (BC ND Iowa 1995), where the Iowa Racing and Gaming Commission revoked the debtor's dog racing license. The revocation was not based solely on the debtor's bankruptcy filing, but due to debtor's failure to demonstrate financial responsibility and viability, as permitted under the Commission's regulations.

II. Associated Entities.

Ray v. Oregon (In Re: Ray), 355 B.R. 253 (Bankr. D. Or. 2006) is instructive with respect to the manner in which the anti-discrimination provisions of 11 U.S.C.S. §525 are applied to entities associated with the debtor. In 2001, Matthew Ray filed Articles of Incorporation with Oregon's Secretary of State for Matt Ray Construction, Inc.. In June, 2004, the Articles were amended to change the name of the corporation to Valley Concrete, Inc. Mr. Ray was the president and a shareholder. The corporation obtained a construction contractor license from the Oregon Construction Contractors Board (CCB) and operated in good standing until Articles of Dissolution were filed by Mr. Ray on September 21, 2005. At the time of dissolution, the corporation owed money to Hughes Lumber Co. and Rock N Ready Mix, LLC. Those debts are still owing. Mr. Ray and his wife filed bankruptcy on October 15, 2005, listing Mr. Ray's personal guarantee of the two outstanding corporate debts on their Schedule F. An order was entered on February 14, 2006 which discharged the debtors' personal obligation to pay the two corporate debts. In November, 2005, Mr. Ray applied for a construction contractor license from the CCB to operate as a sole proprietor. The CCB denied the application, citing ORS 701.102, on the grounds that Mr. Ray was an officer of a business which had unpaid final orders for claims against it at the time of the application.

ORS 701.102(2)(c), the provision used by the CCB to deny Mr. Ray a new construction contractor license, provides as follows:

"(2) The Construction Contractors Board may suspend or refuse to issue a license required under this chapter to a business if:

***

(c) An owner or officer of the business [applying for a license] was an owner or officer of another business at the time the other business incurred a construction debt that is owing or at the time of an event that resulted in the revocation or suspension of the other business's construction contractor license."

The debts to Hughes Lumber Co. and Rock N Ready Mix, LLC which remained due and owing by Valley Concrete, Inc. were defined as construction debts under a separate section of the Oregon revised statutes.

While acknowledging that the debtors' personal obligation to pay the debts in question were discharged in their bankruptcy, the CCB argued that it had not violated §525 because the unpaid debts, being debts of the corporation, which had not filed for bankruptcy, are not dischargable. The CCB urged that it conditions license approval on the payment of the nondebtor corporation's debts, not the debts owed by Mr. Ray as guarantor. Relying on Perez v. Campbell (Supra), the Rays countered that requiring a debtor to pay a debt for which his obligation has been discharged in bankruptcy is an attempt to carve out an exception to §525(a) and is at odds with congressional intent in providing a fresh start to debtors.

The Court found that the Oregon statute in issue frustrated the full effectiveness of the federal law, noting that in order to obtain a license to work in his field of business, the debtor must either pay debts which he is not legally obligated to pay

because his obligation was discharged in bankruptcy, or he must file bankruptcy under Chapter 11 for his insolvent and dissolved corporation. The Court adopted with approval a statement in a case with nearly identical facts to those in Ray stating: "the debtor could not, and should not, be required to attempt to confirm a costly plan of reorganization in order for [the corporation] to receive a discharge under 11 U.S.C.S. §1141(d), solely to satisfy the requirements of" state law. Here, Mark W. McCann should not be required to incur the cost of filing a costly Chapter 11 bankruptcy proceeding for McC Oil Company, Inc. (herefter "McC") simply for it to receive a discharge.

III. Oil and Gas Regulation.

Application of 11 U.S.C.S. §525(a) in the oil and gas regulatory arena was recently addressed in In Re: Aurora Gas, LLC, 64 Bankr. Ct. Dec. (LRP) 182 (Bankr. D. Alaska Sept. 26, 2017). The debtor in that case, Aurora Gas, LLC (Aurora Gas) operated 19 oil and gas wells in south central Alaska's Cook Inlet. Aurora Gas leased ten wells from Cook Inlet Regional, Inc. (CIRI), and nine wells from the State of Alaska (State). The wells leased from the State were separated into two distinct groups based on their locations. Three of the State's leased wells were located in the Three Mile Creek Unit. The remaining six wells leased from the State were located in the Nicolai Creek Unit.

Unable to successfully reorganize, Aurora Gas sought to sell its assets. The debtor realized it would not be able to sell its nonoperational wells. It sought to plug the nine CIRI wells, except a disposal well, and the three Three Mile Creek Wells. As

part of the process, Aurora Gas sought, and obtained Court approval, to reject the nine leases with CIRI with the State for the Three Mile Creek wells. Aurora Gas continued its efforts to sell the operational wells in the Nicolai Creek Unit. It obtained an offer to sell five of the State leases/wells in the Nicolai Creek Unit, which the bankruptcy court approved subject to the approval of the Alaska Oil and Gas Conservation Commission (AOGCC). The AOGCC entered its Decision and Order on the purchaser's request that it be substituted (as operator) for Aurora Gas on the Nicolai Creek Unit. It conditioned substitution of the purchaser for Aurora Gas on one of two conditions:

> (1) that the purchaser post a bond in the amount of $200,000 and agree to plug and abandon the three Three Mile Creek wells; or
>
> (2) post a bond in the amount of $6,000,000 over a three-year period, $2,000,000 per year.

Roughly a week after entry of the AOGCC Decision and Order, the purchaser filed its motion in bankruptcy court alleging that the AOGCC impermissibly discriminated against it based upon the bankruptcy filing of Aurora Gas.

The AOGCC opposed the Motion on a number of grounds. Relevant to this case are the Fourth and Fifth grounds, in which the AOGCC argued that §525 cannot apply to the Decision because it was not made solely based upon Aurora Gas' bankruptcy, and the debt will not be discharged by the bankruptcy, and that §525(a) protects Aurora Gas, not the purchaser, and thus relief was not available to the purchaser under that section.

Finding that the decision of the AOGCC was an attempt to collect the debtor's prepetition liability to plug the Three Mile Creek wells, for which the Alaska Department of Natural Resources had no budget surplus from which to draw the necessary plugging costs, the Court found the order in violation of §525(a) as well as the automatic stay provisions of 11 U.S.C.S. §362(a)(3) and (a)(6).

In Aurora Gas, the Court found that the proximate cause triggering the AOGCC decision was the failure of Aurora Gas to pay its well plugging and abandonment costs, citing with approval language from FCC v. NextWave Pers. Comnc'ns, Inc., 537 U.S. 293, 301-302, 123 S. Ct. 832, 154 L. Ed. 2d 863 (2003):

> "When the statute refers to failure to pay a debt as the sole cause of cancellation (solely because), it cannot reasonably be understood to include, among the other causes whose presence can preclude application of the prohibition, the governmental unit's *motive* in effecting the cancellation. Such a reading would deprive §525 of all force. It is hard to imagine a situation in which a governmental unit would not have some further motive behind the cancellation - assuring the financial solvency of the licensed entity, or punishing lawlessness, or even (quite simply) making itself financially whole. §525 means nothing more or less than that the failure to pay a dischargeable debt must alone be the proximate cause of the cancellation - the act or event that triggers the agency's decision to cancel, whatever the agency's ultimate motive in pulling the trigger may be."

IV. McCann Bankruptcy.

As an attachment to its Opening Brief, Quito, Inc. submits the following copies of documents from the United States Bankruptcy Court in Case No. 98-42372, In Re: Mark W. McCann:

(1) Summary of Schedules, including Schedules A through J;
(2) Statement of Financial Affairs;
(3) Amended Creditor Matrix;
(4) Order Upon Conversion of Case Under Chapter 13 to Case Under Chapter 7 by Debtor; and
(5) Discharge of Debtor and Final Decree.

V. Facts of Present Case; Application of Bankruptcy Code.

As set forth in the Stipulations of Fact submitted herein by Quito, Inc. and Commission Staff, McC was incorporated in 1994; Mark W. McCann was its sole officer and stockholder; it was issued an operator's license which became inactive on March 30, 1999, and at the time the license became inactive, McC was identified as the operator responsible for plugging four (4) wells located in Chautauqua County, Kansas. A consent to dissolution of McC was filed with the Kansas Secretary of State on December 30, 1998.

Prior to its dissolution, McC executed a Release of the four leases upon which the wells were located. Attached hereto as Exhibit "A' is a file-stamped copy of the Release of Oil and Gas Lease recorded in the office of the Register of Deeds of Chautauqua County, Kansas.

As further set forth in the Stipulations of Fact Nos. 6 through 9, Mark W. McCann filed his Voluntary Petition under Chapter 13 of the Bankruptcy Code on August 8, 1998 listing the State of Kansas as a creditor holding an unsecured non-priority claim. Schedule F of the Petition identified the claim as: "1970, 1980, 1990s liability for

plugging oil and gas wells", and that the claim was contingent, unliquidated and disputed in the amount of $500,000.00. On April 29, 1999, an order was entered in the bankruptcy case converting it from a Chapter 13 to a Chapter 7 liquidation. On September 16, 1999, a Discharge of Debtor and Final Decree was entered in Mr. McCann's bankruptcy case.

By letter dated July 24, 2020, addressed to: "Quito, Inc. Mark W. McCann" in reference to renewal of Quito's license #33594, Commission's counsel advised the Operator of receipt of its June 1, 2020 license renewal application, and that available records indicate an association with McC, an "Associated Entity" which is not in compliance with all requirements of K.S.A. Chapter 55. The letter further advised that the Associated Entity has four unplugged wells remaining on its expired license and is suspended under KCC Docket #16-CONS-361-CSHO. Citing K.S.A. 55-155(c)(4), the Commission's counsel advised that no application or renewal shall be approved before the applicant has demonstrated to the Commission's satisfaction that the Operator complies with all the requirements of K.S.A. Chapter 55, and that Quito's application cannot be renewed due to its association with entities that are not in compliance with Commission statutes, regulations, and orders, if further clarifying information is not received. The letter invited the operator to contact Staff to discuss its options.

Counsel for Quito, Inc. initially responded to the July 24, 2020 letter by email dated July 28, 2020, citing In the Matter of the Notice of Denial of License Renewal

Application of Agricultural Energy Services, 17-CONS-3529-CMCS, asserting that the existence of a common officer or director of an applicant for a license who was also an officer or director of a non-compliant associated entity had previously been determined by the Commission to not be a basis for issuance of a license to the applicant. Under the Commission's Order on Briefing, that issue is to be initially briefed by Commission Staff, and will not be addressed further in Quito's Opening Brief.

By letter dated April 2, 2021, addressed to: "Mark W. McCann Quito, Inc.", a copy of which is attached as Exhibit "B" to the Order Denying Application for License issued in this docket on September 2, 2021, the Commission's counsel again advised Quito that its license application could not be approved due to its association with entities that are not in compliance with Commission statutes, regulations and orders.

The stipulated facts demonstrate that the Operator's license of McC became inactive on March 30, 1999. Prior to the license becoming inactive, McC had been voluntarily dissolved by consent on December 30, 1998. The State was listed as an unsecured creditor for any individual liability to which Mr. McCann might be subject (either as the sole officer and shareholder of McC, or by way of predecessor liability under K.S.A. 55-179). See: John M. Denman Oil Co. v. State Corp. Comm'n of Kan., 51 Kan. App. 2d 98, 342 P.3d 958 (Kan. Ct. App. 2015). Although it appears that the State of Kansas did not file a claim in Mr. McCann's bankruptcy proceeding, any liability

which Mr. McCann had theretofore incurred was a "claim" which was "dischargable" under the Bankruptcy Act.

No relief has been sought by McC for its obligation to plug the four wells listed on its expired operator's license. The debt of McC to plug the four wells remains unsatisfied. Quito, Inc. submits that at the time of its dissolution, McC owned no assets, but recognizes this is a fact not established by the stipulations.

K.S.A. 17-6807, in effect at the time of dissolution of McC, provided in pertinent part:

> "All corporations, whether they expire by their own limitation or are otherwise dissolved...shall be continued, nevertheless, for the term of three years from such expiration or dissolution or for such longer period as the district court in its discretion shall direct, bodies corporate for the purpose of prosecuting and defending suits, whether civil, criminal or administrative, by or against them, and of enabling them gradually to settle and close their business, to dispose of and convey their property, to discharge their liabilities and to distribute to their shareholders any remaining assets...".

Sixteen years and nine months after its dissolution, on September 3, 2015, Commission Staff filed a Motion for an Order to Show Cause, the Designation of a Prehearing Officer, and the Scheduling of a Prehearing Conference directed to McC in Docket No.: 16-CONS-361-CSHO (the "Show Cause Motion"). The Show Cause Motion asserted that McC was responsible for four (4) identified wells listed on McC's expired license; that McC appeared to be the responsible party for plugging the wells, and that if McC did not bring these wells into compliance, then its operator's license should be

suspended and any injection authority associated with the unplugged wells should be revoked. A subsequent Order to Show Cause, Designating a Prehearing Officer, and Setting a Prehearing Conference was issued in the same docket on November 6, 2015, in summary finding that the wells were unplugged; that they were listed on McC's license, and that it appeared to be responsible for plugging the wells. A prehearing conference date was scheduled and notice was given. On January 15, 2016, a Default Order was entered suspending McC's license until its compliance was obtained by plugging the wells, reimbursing the Commission for the costs of plugging, or transferring the wells to a licensed operator.

The Default Order in the above docket is telling in respect to its recognition that McC should bear the financial responsibility for the four (4) unplugged wells. Equally telling is the verbiage of Staff's correspondence of June 24, 2020, and April 2, 2021 advising Quito, Inc. that its license could not be renewed "due to its association with entities that are not in compliance with Commission statutes, regulations, and orders".

That McC should bear the financial responsibility for the four (4) unplugged wells wells is a proposition upon which there appears to be no debate. Quito, Inc. submits that McC has no assets and lacks the financial ability to comply with the Commission's Order in Docket No. 16-CONS-361-CSHO, but also recognizes this is a fact not established by the stipulations.

Quito, Inc. and McC share a common denominator - Mark W. McCann is the sole shareholder and officer of Quito, Inc.; he was the sole shareholder and officer of McC. His individual liability to plug the wells has been discharged in bankruptcy. His declination to individually assume or discharge the financial liability of an entity with whom he was associated for the four (4) unplugged wells on McC's expired and suspended license is the proximate cause for Commission Staff's refusal to renew the Operator's License of Quito, Inc.. This basis for denial of license renewal contravenes the clear purpose of §525(a) of the Bankruptcy Code. The Commission should determine that Quito, Inc. is entitled to renewal of its license.

SUBMITTED BY:

JOHN R. HORST, P.A.

By /s/ John R. Horst
JOHN R. HORST
207 W. FOURTH AVE.
P.O. BOX 560
CANEY, KS 67333
Attorney for Quito, Inc.
Our File #2844
S. Ct. #09412

CERTIFICATE OF SERVICE

22-CONS-3115-CMSC

I, the undersigned, certify that a true copy of the attached Opening Brief of Quito, Inc. has been served to the following by means of electronic service on March 25, 2022.

Nancy Borst
Kansas Corporation Commission
Central Office
266 N. Main St, Ste 220
Wichita, KS 67202-1513
n.borst@kcc.ks.gov

Kelcey Marsh, Litigation Counsel
Kansas Corporation Commission
Central Office
266 N. Main St, Ste 220
Wichita, KS 67202-1513
k.marsh@kcc.ks.gov

Jonathan R. Myers, Assistant General Counsel
Kansas Corporation Commission
266 N. Main St., Ste. 220
Wichita, KS 67202-1513
j.myers@kcc.ks.gov

/s/ John R. Horst
JOHN R. HORST

RELEASE OF OIL AND GAS LEASE

KNOW ALL MEN BY THESE PRESENTS:

That McC Oil Company, Inc., does hereby release, relinquish and surrender to the Lessors identified in Exhibit "A" attached hereto, their heirs, assigns and legal representatives, all right, title and interest, in and to the Oil and Gas Leases described in Exhibit "A" attached hereto.

Witness the following signature of the present owner this 18th day of December, 1998.

McC OIL COMPANY, INC.

By: _____
MARK W. McCANN, President

ACKNOWLEDGMENT

STATE OF KANSAS)
)ss:
COUNTY OF MONTGOMERY)

The foregoing instrument was acknowledged before me this 18th day of December, 1998, by Mark W. McCann as president of McC Oil Company, Inc., a Kansas corporation, on behalf of the corporation.

_____
NOTARY PUBLIC

My Appointment Expires: Feb. 5, 2001

TERESA A. ROLLS
Notary Public - State of Kansas
My Appt. Expires 02/05/2001

STATE OF KANSAS } SS
Chautauqua County }

This instrument was filed for record this 22nd day of December 1998 at 10:00 o'clock A M and duly recorded in book 100 of records on page 603

_____
REGISTER OF DEEDS

C:\FORMS\O&G\WORK\MCCANNRE.DOC-2

EXHIBIT
tabbies
A

EXHIBIT "A"

1. FLOYD CASEMENT

Lessor: Floyd Casement and Hazel J. Casement, husband and wife
Lessee: McCann Drilling, Inc.
Date: January 24, 1980
Recorded: Book 45 of Leases, Page 530
Property: The N/2 of the NW/4, Sec. 7, Twp. 34S, Rge. 11E, Chautauqua County, Kansas

2. McELROY

Lessor: A. Louise McElroy
Lessee: M. G. Keeny, M.D.
Date: August 16, 1979
Recorded: Book 45 of Leases, Page 119
Property: The E/2 SW/4 and the SW/4 SE/4, Sec. 7, Twp. 35S, Rge. 12E, Chautauqua County, Kansas

Lessor: Mahala Ellen Steiner Busse, a widow
Lessee: Earl Tresner
Date: June 18, 1990
Recorded: Book 65 of Leases, Page 23
Property: The NE/4 SW/4 the E/2 SE/4 SW/4, the SE/4 SE/4 SW/4 and the SW/4 SE/4, Sec. 7, Twp. 35S, Rge. 12E, Chautauqua County, Kansas

Lessor: Mahala Ellen Steiner Busse, a widow
Lessee: M. G. Keeny, M.D.
Date: January 26, 1981
Recorded: Book 49 of Leases, Page 604
Property: The NW/4 of the SE/4 of the SW/4, Sec. 7, Twp. 35S, Rge. 12E, Chautauqua County, Kansas

3. MILLER

Lessor: Hazel L. Miller
Lessee: Andy A. Focht and Ray Wolfe
Date: April 15, 1981
Recorded: Book 51 of Leases, Page 304
Property: The SE/4 of the SE/4 of the NE/4, Sec. 27, Twp. 34S, Rge. 11E, Chautauqua County, Kansas

4. MOORE

Lessor: Bonnie S. Moore, a single person
Lessee: Mark W. McCann
Date: January 25, 1990
Recorded: Book 63 of Leases, Page 591
Property: The SW/4 of the NW/4 and the W/2 of the SW/4, Sec. 7, Twp. 35S, Rge. 12E, Chautauqua County, Kansas