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State Corporation Commission
of Kansas

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

RESPONSE BRIEF OF COMMISSION STAFF

The Staff of the State Corporation Commission of the State of Kansas (Staff and Commission, respectively) submits its response to Operator's *Opening Brief of Quito, Inc.* (Operator's Brief) filed on March 25, 2022, pursuant to the Commission's *Order on Briefing, and Requiring Staff Report and Further Investigation*.

I. Introduction and Roadmap

1. Operator has repeatedly asserted that the federal bankruptcy code requires the Commission to renew its license — to do otherwise would be to violate federal law. As this brief will argue, the Commission's denial of Operator's license renewal in no way violates the Bankruptcy Act. In fact, Operator's invocation of the bankruptcy code is merely an attempt to skirt responsibility for wells that pose a threat to the usable waters of the State of Kansas. While the bankruptcy code exists as a means to give individuals and corporations a fresh start, that fresh start does not include allowing a person to simply walk away from ongoing environmental harm. Federal courts, including the U.S. Supreme Court, have consistently held that while the bankruptcy code may allow persons to discharge a wide range of liabilities, it does not allow persons to discharge liability for ongoing environmental threats. This brief will explain that the federal bankruptcy code does not apply in this docket, and that the Commission should therefore affirm the denial of Operator's license.

2. To show why the bankruptcy code does not apply in this docket, the brief begins with a discussion of McC Oil Company, Inc. (McC Oil), and the manner in which the corporation ended. The brief then considers the relevant sections of the bankruptcy code and the case law interpreting that code. The brief concludes by explaining how a proper application of the bankruptcy code and case law shows that Operator may not use bankruptcy law to avoid responsibility for the decisions of its sole shareholder.

II. Mr. McCann is Responsible for the McC Oil Wells

3. K.S.A. 17-6804 details the steps stockholders of a corporation must follow for a corporation to be dissolved. The statute states that a corporation may be dissolved if "all the stockholders entitled to vote thereon shall consent in writing and a certificate of dissolution shall be filed with the secretary of state."[1] There are thus two requirements: 1) stockholder consent in writing, and 2) a certificate of dissolution filed with the Secretary of State. On December 30, 1998, McC Oil filed a "Consent to Dissolution" indicating that the sole stockholder, Mr. McCann, consented to the dissolution. However, McC Oil does not appear to have filed a certificate of dissolution as required by the statute. Whether McC Oil was properly dissolved appears to be an unresolved question. Nevertheless, the Commission could reasonably conclude that the "Consent to Dissolution" filed by McC Oil acted as a certificate of dissolution, thereby dissolving McC Oil as a corporation. Throughout the rest of this brief, Staff will assume that McC Oil was properly dissolved in 1998.[2]

[1] K.S.A. 17-6804(c).

[2] It should be noted that Staff's *Brief of Commission Staff*, filed March 25, 2022, argued that an individual associated with Operator was still associated with McC Oil, and therefore Operator's license should not be renewed under K.S.A 55-155(c)(4) and K.A.R. 82-3-120(g)(2). That brief relied on the inherent argument that McC Oil had not been properly dissolved, and that the property owned by McC Oil had not been properly conveyed to the shareholder (*see Pottorf v. U.S.*, F.Supp. 1491 (1991)). Staff intends to argue in the alternative regarding the state of McC Oil in the different briefing questions outlined by the Commission. As such, Staff's current brief and Staff's brief filed March

4. K.S.A. 17-6810 determines what happens to property owned by a corporation when the corporation dissolves. After any claims or obligations are paid, "[a]ny remaining assets shall be distributed to the stockholders of the dissolved corporation."[3] Before McC Oil dissolved, it owned at least four wells. A well is a tangible object, consisting of cement, metal casing, tubing, valves, etc. Under Kansas tax law, all "casing, tubing or other material therein, and all other equipment and material used in operating" oil or gas wells are personal property.[4] This personal property has value, which explains why the State taxes the property. Thus, an oil or gas well is an asset of the corporation that owns the well. Moreover, a well does not simply disappear when the corporation that owns the well is dissolved. As the well is an asset belonging to the corporation, when the corporation is dissolved the well becomes an asset belonging to the shareholders of the corporation. In this case, Mr. McCann was the sole shareholder of McC Oil. When McC Oil dissolved, the assets of McC Oil devolved to Mr. McCann as assets of his personal estate. Consequently, when the corporation dissolved, Mr. McCann became the owner of the four wells previously owned by McC Oil.

5. Mr. McCann appears to agree that he became the owner of the wells when McC Oil dissolved. Mr. McCann filed personal bankruptcy in 1998. In his bankruptcy filings, Mr. McCann listed his "liability for plugging oil and gas wells." If the wells were owned by McC Oil, then Mr. McCann would have no personal liability to plug the wells. However, as Mr. McCann listed the liability in his bankruptcy filing, he clearly believed that he was personally responsible for plugging the wells.

25, 2022, should be thought of as arguments made in the alternative. Both arguments end at the same result—that Operator's license should not be renewed—the only difference being the factual and legal path taken to get there.

[3] K.S.A. 17-6810(b)(2).

[4] K.S.A. 79-329.

6. Operator argues in its Brief that by listing the well pluggings as a liability, Mr. McCann's liability for the wells was discharged when the bankruptcy court entered its Discharge of Debtor and Final Decree on September 16, 1999.[5] However, Mr. McCann was only released from his dischargeable debts.[6] As will be explained next, though, the wells to this day remain a part of Mr. McCann's personal estate. More importantly, the bankruptcy court did not have authority to discharge Mr. McCann's liability for the wells.

III. Mr. McCann's Liability Was Not Discharged in Bankruptcy

7. Under 11 U.S.C. 554(a) of the bankruptcy code, a trustee may abandon property of an estate during bankruptcy, but only after notice and a hearing. Property of the estate not abandoned remains property of the estate.[7] In Mr. McCann's bankruptcy case, there was no notice and a hearing regarding abandoning the McC Oil wells that had become part of Mr. McCann's estate. As a result, under the bankruptcy code, the McC Oil wells were never properly abandoned and the wells remain a part of Mr. McCann's personal estate.

8. Moreover, the U.S. Supreme Court held in *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, that a trustee in a bankruptcy proceeding may not abandon property in contravention of a state statute or regulation designed to protect the public health or safety from hazards.[8] The Court further ruled that a bankruptcy court "does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety."[9] In this docket, the bankruptcy court did not formulate any conditions for the abandonment of the wells that became part of Mr. McCann's estate. Thus, the bankruptcy court did nothing to

[5] Operator's Brief, pp. 11-12 (Mar. 25, 2022).
[6] *Id*.
[7] 11 U.S.C. 554(d).
[8] 474 U.S. 494, 505 (1986).
[9] *Id.* at 507.

ensure adequate protection of the public's health and safety. Again, the wells are not abandoned property and still remain a part of Mr. McCann's personal estate. This means that Mr. McCann retains responsibility for keeping those wells in compliance with Chapter 55 of the Kansas Statutes Annotated, as well as all Commission rules and regulations. Mr. McCann has taken no action to keep the wells in compliance with Kansas statutes and regulations since at least 1998. Staff would posit that abandoned wells are by their very nature environmental hazards to public health and safety, much less, wells that have been abandoned and out of compliance for over two decades.

9. More importantly, liability for an ongoing environmental threat may not be discharged in bankruptcy. The U.S. Supreme Court in *Ohio v. Kovacs* ruled on the ability of a debtor to discharge environmental liability in a bankruptcy proceeding.[10] In *Kovacs*, the State of Ohio sought reimbursement for cleaning up a hazardous waste disposal site owned by a corporation in which Kovacs was chief executive officer. As the Supreme Court noted, the only performance that Ohio wanted was the payment of money.[11] Consequently, the Court held that Ohio's order to clean up the hazardous waste site was merely an obligation to pay money, and was therefore dischargeable in bankruptcy.[12] The Court was quick to point out, however, that the discharge of Kovacs' debt to pay the cleanup costs did not "shield him from prosecution for having violated the environmental laws of Ohio."[13] The Court continued that it was <u>not</u> ruling that "any conduct that will contribute to the pollution of the site or the State's waters is dischargeable in bankruptcy."[14] The Court concluded by writing that "we do not question that anyone in possession of the site . . . must comply with the environmental laws of the State of Ohio."[15] The Court in

[10] 469 U.S. 274 (1985).
[11] *Id.* at 283.
[12] *Id.*
[13] *Id.* at 284.
[14] *Id.*
[15] *Id.*

Kovacs thus held that reimbursement for cleaning up an environmental threat is dischargeable in bankruptcy, but if the debtor is responsible for an ongoing environmental threat, the liability is not dischargeable in bankruptcy.

10. In an influential decision, the U.S. Court of Appeals in *In re Chateaugay Corp.* ruled more directly on what types of environmental liabilities may or may not be discharged in bankruptcy.[16] In that case, the Court held that an order by the government to clean up a site that imposes an obligation "distinct from any obligation to stop or ameliorate ongoing pollution" is a claim that may be discharged in bankruptcy.[17] However, any order that "to any extent ends or ameliorates continued pollution is not an order for breach of an obligation that gives rise to a right of payment and is for that reason not a 'claim'" that may be discharged in bankruptcy.[18] Any order by the Commission to bring a well into compliance with Commission regulations is done to end or ameliorate the possibility of ongoing pollution by the well. Under *Kovacs* and *Chateaugay*, such an order is therefore not dischargeable in bankruptcy. In the present docket, had the Commission used State funds to plug Mr. McCann's wells, the cost to reimburse the Commission for plugging those wells would have been dischargeable in bankruptcy.[19] However, the wells at issue have not been plugged, and are still in the possession of Mr. McCann. Mr. McCann's liability for the potential pollution the former McC Oil wells are causing to the waters of the State of Kansas is therefore not dischargeable in bankruptcy. The bankruptcy court did not discharge Mr. McCann's liability for the wells because such liability simply is not dischargeable in bankruptcy.

[16] 944 F.2d 997 (1992) (Ruling by the Second Circuit Court of Appeals, making the case persuasive in the Tenth Circuit).
[17] *Id.* at 1008.
[18] *Id.* (*See also*, *In re Torwico Electronics, Inc.*, 8 F.3d 146 (1993) and *U.S. v. Apex Oil, Inc.*, 579 F.3d 734 (2009)).
[19] *See* Docket 12-CONS-139-CSHO, Order on Reconsideration (Jul. 20, 2012) (Commission ruled that Operator's obligation to reimburse the Commission for plugging three wells had been discharged in Operator's bankruptcy proceedings).

IV. 11 U.S.C. 525(a) Does Not Apply in This Docket

11. Operator in its Brief argues that the bankruptcy code in 11 U.S.C. 525(a) prevents governmental units from refusing to renew a license "solely because" a person has been a debtor under the Bankruptcy Act.[20] As Operator's Brief correctly points out, the U.S. Supreme Court in *F.C.C. v. NextWave Personal Communications Inc.* took a broad view of the meaning of "solely because" in the statute, and held that a governmental unit's "motive" in refusing to renew a license was unimportant.[21] However, the *NextWave* case involved a debtor whose debt was dischargeable in bankruptcy. As 11 U.S.C. 525(a) states, governmental units may not refuse to renew a license "solely because such bankrupt or debtor . . . has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act."

12. As explained in the previous section, Mr. McCann's liability for the wells was not dischargeable in bankruptcy because the wells constitute an ongoing pollution threat. 11 U.S.C. 525(a) only applies to liabilities that are dischargeable. As Mr. McCann's liability for the former McC Oil wells was not dischargeable in bankruptcy, the statute does not apply in this docket.

13. Operator's Brief relies heavily on *In re Aurora Gas, LLC,*[22] in arguing that 11 U.S.C. 525(a) should be interpreted to require the Commission to renew Operator's license.[23] It should be noted that the case is an unpublished decision from the Bankruptcy Court in Alaska, and thus of limited persuasive authority. More crucially, the facts in the *Aurora* case bear almost no resemblance to the facts in this docket. In the *Aurora* case, Aurora Gas, LLC (Aurora Gas), operated nineteen oil and gas wells in Alaska when it filed for bankruptcy. Aurora Exploration LLC (AE), a company unrelated to Aurora Gas, wanted to purchase five of Aurora Gas' oil and

[20] 11 U.S.C. 525(a).
[21] 537 U.S. 293, 301 (2003).
[22] 2017 WL 4325560 (D. Alaska, 2017)
[23] *See* Operator's Brief, pp. 6-8 (Mar. 25, 2022).

gas leases. The Alaska Oil and Gas Conservation Commission (AOGCC) refused to approve the transfer of the five wells to AE unless AE plugged the other wells owned by Aurora Gas, or posted a $6,000,000 bond. The Bankruptcy Court held that AOGCC was attempting to compel AE to plug Aurora Gas' wells by requiring AE to either plug the wells or pay an exorbitant bond. The Court also found that AOGCC had violated 11 U.S.C. 525(a) by discriminating against AE and Aurora Gas because Aurora Gas had declared bankruptcy and AOGCC believed it would be unable to plug its other wells.

14. The facts in the present docket are very different. Mr. McCann is personally liable for the wells previously owned by McC Oil, and is also the sole officer of Operator. Under K.S.A. 55-155(c)(4), the Commission may not renew the license of an operator if an officer of the operator is not in compliance with Kansas oil and gas statutes as well as Commission rules and regulations. The only way in which the *Aurora* decision would be comparable to this docket would be if both Aurora Gas and AE were owned and operated by the same officers, and the bankruptcy of Aurora Gas and the sale of wells from one company to the other was merely a shell game designed to skirt the power of the AOGCC. Here, Mr. McCann is indeed trying to use bankruptcy law to skirt the power of the Commission to enforce Kansas oil and gas statutes and regulations.

V. Conclusion

15. If the Commission finds that McC Oil has been properly dissolved, then the wells that had been the property of McC Oil devolved to Mr. McCann's personal estate. As Mr. McCann did not abandon the wells during his bankruptcy proceedings, those wells remain tangible personal property of Mr. McCann's estate. More importantly, the bankruptcy court did not have the power to discharge Mr. McCann's liability for the environmental threat posed by those wells. The U.S. Supreme Court and U.S. Appeals Courts have consistently held that liability for an ongoing

environmental threat is not a claim that may be discharged in bankruptcy. As liability for the wells may not be discharged, 11 U.S.C. 525(a) does not apply in this docket. Consequently, the Commission should deny Operator's license renewal—Operator's sole officer is not in compliance with Chapter 55 of the Kansas Statutes Annotated or Commission rules and regulations, and thus under K.S.A. 55-155(c)(4) and K.A.R. 82-3-120(g)(2) the license renewal must be denied.

WHEREFORE, for the reasons stated above, the Commission's license denial order did not violate the federal bankruptcy code.

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CERTIFICATE OF SERVICE

22-CONS-3115-CMSC

I, the undersigned, certify that a true and correct copy of the attached Response Brief of Commission Staff has been served to the following by means of electronic service on April 15, 2022.

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