COMPLICATIONS IN MINERAL RELATED BANKRUTPCIES

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If bankruptcy is filed, an "estate" is automatically created. The "bankruptcy estate" becomes its own collection of property rights. It is broadly defined under the Bankruptcy Code (11 U.S.C. § 541) as being "all legal or equitable interests of the debtor in property as of the commencement of the case, wherever located and by whomever held." It also includes the "proceeds, product, offspring, rents, or profits of or from property of the estate…"

There are several statutory examples of specific interests which are excluded from the estate, including any "liquid or gaseous hydrocarbons" to the extent that the debtor has transferred or has agreed to transfer such interests pursuant to a "farm-out agreement" or to the extent that the debtor has transferred the interests pursuant to a "written conveyance of the production payment." The interpretation of this special provision has not yet been litigated or tested in Kentucky.

Unless there is some particular and specific federal interest requiring a different result, all property interests are created by and defined by state law, pursuant to the Supreme Court decision of *Butner v. U.S.*, 440 U.S. 48 (1979). In almost all cases, state law will govern, so decisions from other jurisdictions may produce differing results and interpretations.

DelCotto Law Group often works with lawyers who specialize in mineral law including both coal and oil and gas cases. The nuances of property ownership rights under state mineral laws, when colliding with bankruptcy law, is murky at best and can become an extremely expensive proposition in a dispute over whether interests are or are not "property of the estate." Surface rights, mineral rights, leasehold interests, life estates, numerous estate heirs, working

interests, production payments, assignments, overrides and overriding royalties, and fee property ownership versus leasehold interests, each can have unique nuances in bankruptcy. The law is unsettled enough that parties on both sides could debate these issues in an expensive battle.

For instance, most of the coal bankruptcies in Kentucky have treated mineral leasehold interests as being "leases" in bankruptcy, leases that can be assumed, assigned, or rejected under 11 U.S.C. § 365. However, there is also some Kentucky law holding that mineral leasehold interests are a true ownership fee interest, not a lease at all. This distinction is very important in bankruptcy settings, because leasehold interests have numerous special provisions that apply to them as opposed to outright ownership.

As both the coal and oil and gas industries go through their current economic readjustments, we anticipate these issues to become crucial ones if bankruptcy is involved. Analysis of the various risks and rewards should be reviewed in advance of filing.

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