Docket #0297 Date Filed: 07/23/2018

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
ENDURO RESOURCE PARTNERS LLC, et al.,	:	Case No. 18-11174 KG
	:	
	:	**Hearing Date: July 30, 2018, at 10:00 AM**
Debtors.	:	**Objections Due: July 23, 2018, at 5:00 PM**
	:	

OBJECTION BY THE UNITED STATES
TO THE DEBTORS' MODIFIED JOINT PLAN OF LIQUIDATION

The United States, on behalf of its Department of Interior ("DOI"), by and through the undersigned attorneys, hereby objects to the Debtors' Modified Joint Plan of Liquidation of Enduro Resource Partners LLC and its Debtor Affiliates under Chapter 11 of the Bankruptcy Code ("Plan"). [DI 193]. In support of its objection, the United States respectfully states as follows:

1. On May 15, 2018, the Debtors filed voluntary bankruptcy petitions seeking chapter 11 relief under the Bankruptcy Code in the Bankruptcy Court for the District of Delaware. [DI 1].

2. On May 16, 2018, the Debtors filed a motion to establish bar dates. [DI 30]. The deadline for governmental units to file proofs of claim is November 12, 2018.

3. On May 16, 2018, the Debtors filed the Motion for Entry of (A) Order (I) Approving Bidding Procedures in Connection with Sale of Assets of the Debtors and Related Bid Protections, (II) Approving Form and Manner of Notice, (III) Scheduling Auction and Sale Hearing, (IV) Authorizing Procedures Governing Assumption and Assignment of Certain Contracts and Unexpired Leases, and (V) Granting Related Relief; and (B) Order (I) Approving Purchase Agreements, and (II) Authorizing Sale Free and Clear of all Liens, Claims,

Encumbrances, and Other Interests ("Sale Motion"). [DI 20]. The United States filed a Limited Objection and Reservation of Rights to the Debtors' Proposed Sale Transactions ("Objection"). [DI 239]. To resolve the Objection, the Debtors included language in each of the four orders approving the Sale Motion, that among other provisions, precluded the automatic assumption and assignment of the Federal Leases and required the Debtors and the prospective purchasers to comply with all applicable non-bankruptcy law with respect to the Federal Leases. [DI 290, 291, 292 and 293].

4. Federal records indicate that the Debtors have an interest in at least 106 Federal Leases and that the Debtors owe the DOI approximately $362,195.32. These numbers are based on the best information presently available.

5. At all relevant times, DOI was and is the agency of the United States charged, *inter alia,* with discretionary authority over the management of oil and gas rights on federal land pursuant to the Mineral Leasing Act of 1920 ("MLA"), 30 U.S.C. § 181 et. seq. and other applicable Acts.

6. On May 18, 2018, the Debtors filed a Chapter 11 Plan of Liquidation. [DI 71]. On June 18, 2018, the Debtors filed the Plan. The United States objects to Article V.A of the Plan which provides; "The transactions contemplated by the Plan shall be approved and effective as of the Effective Date, without the need for any further state or local regulatory approvals or approvals by any non-Debtor Parties, and without any requirement for further action by the Debtors, their board of directors, their stockholders, or any other person or entity." Section 365(b) of the Bankruptcy Code provides that a debtor-in-possession may not assume an executory contract or unexpired lease in default unless the debtor-in-possession: (1) cures the default or provides adequate assurance of a prompt cure; (2) compensates the non-debtor party to

the contract or lease for the pecuniary loss suffered from the default or provides adequate assurance of future performance under the contract or lease. 11 U.S.C. § 365(b)(1)(A)-(C). Further, a debtor may not assume or assign any executory contract or unexpired lease of the debtor if applicable law excuses the other party from accepting performance from other than the debtor and such party does not consent to such assumption or assignment. 11 U.S.C. § 365(c)(1)(A) & (B). Finally,"[n]otwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property . . . proposed to be . . . sold . . . the court shall . . .prohibit or condition such sale . . . as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e).

7. Consistent with the Bankruptcy Code, the MLA provides that no federal lease may be assigned or sublet or otherwise transferred without the consent of the Secretary of Interior. 30 U.S.C. § 187. The regulations require specific approval for assumption and assignment of federal oil and gas interests. The DOI Bureau of Land Management regulations, 43 C.F.R. § 3106.1 and 43 C.F.R. § 3106.7-2, also require approval of assignments or transfers of leases and agreements. Prerequisites to such approval include, but are not limited to, the payment of the actual cure amounts, the cure of existing contract and lease defaults, the assumption of decommissioning obligations, and the posting of appropriate bonds or other security and the qualification of the assignee to hold a lease or other agreement. The United States objects to the Sale Motion because it is not consistent with federal law. The Assignment of Contracts Act provides that a party to a federal contract may not transfer the contract or any interest in the contract. 41 U.S.C. § 6305. Under this Act, Debtors may not assign or assume a contract with the United States without first obtaining its consent. *In re West Electronics, Inc*., 852 F.2d 79, 83 (3d Cir. 1988). Accordingly, the Debtors may not assign any of their interests in

the Federal Leases without the specific approval of the Secretary of Interior. Such approval is contingent upon the Debtors meeting all of the regulatory criteria for such consent, *inter alia*, cure of any and all lease/contract defaults, adequate financial assurances relating to bonds, etc., and assumption of all obligations, including audit and decommissioning obligations.

8. Further, the United States seeks clarification about the automatic rejection provision set forth in Article VI.A which appears to be inconsistent with the Sale Orders and provides "As of the Effective Date, the Debtors shall be deemed to have rejected all Executory Contracts and Unexpired Leases that (1) have not been previously rejected, assumed, or assumed and assigned, including in connection with any Sale, and (2) have not expired under their own terms prior to the Effective Date. The Confirmation Order shall constitute an order of the Bankruptcy Court approving the foregoing rejections pursuant to sections 365 and 1123 of the Bankruptcy Code as of the Effective Date."

9. The Debtors propose in Article VII.C of the Plan that distributions made after the Effective Date to Holders of Disputed Claims that are not Allowed Claims as of the Effective Date but which later become Allowed Claims shall be deemed to have been made on the Effective Date. Article VIII.D of the Plan specifically provides that no interest will be paid on such claims. The United States objects to Articles VII.C and VIII.D of the Plan to the extent that the Debtors are not paying interest on the claims of the United States that would otherwise be entitled to interest.

10. The United States objects to Article X of the Plan to the extent it fails to preserve the United States' setoff and recoupment rights. Confirmation of a plan does not extinguish setoff claims when they are timely asserted. *In re Continental Airlines,* 134 F.3d at 542 (3d Cir. 1998). Like other creditors, the United States has the common law right to setoff mutual debts.

"The government has the same right which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." *United States v. Munsey Trust Co. of Washington, D.C.*, 332 U.S. 234 (1947) (citing *Gratiot v. United States*, 40 U.S. (15 Pet) 336, 370, 10 L.Ed. 759 (1841)); *see also Amoco Prod. Co. v. Fry*, 118 F.3d 812, 817 (D.C. Cir. 1997). This right – "which is inherent in the federal government – is broad and 'exists independent of any statutory grant of authority to the executive branch.'" *Marre v. United States*, 117 F.3d 297, 302 (5th Cir. 1997) (quoting *United States v. Tafoya*, 803 F.2d 140 (5th Cir. 1986)). Hence, the United States can setoff mutual prepetition debts and claims as well as postpetition debts and claims. *Zions First Nat'l Bank, N.A. v. Christiansen Bros*. (*In re Davidson Lumber Sales, Inc.*), 66 F.3d 1560, 1569 (10th Cir. 1995); *Palm Beach County Bd. of Pub. Instruction (In re Alfar Dairy, Inc.)*, 458 F.2d 1258, 1262 (5th Cir.), *cert. denied*, 409 U.S. 1048 (1972); *Mohawk Indus., Inc. v. United States (In re Mohawk Indus., Inc.)*, 82 B.R. 174, 178-79 (Bankr. D. Mass. 1987). The Plan makes no provision for these rights. Such treatment is impermissible, because Section 553 of the Bankruptcy Code preserves the right of setoff in bankruptcy as it exists outside bankruptcy, *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995), neither expanding nor constricting it, *United States v. Maxwell*, 157 F.3d 1099, 1102 (7th Cir. 1998). "[T]he government of the United States suffers no special handicap under § 553 of the Bankruptcy Code," *id*. at 1103, that alters this principle. Moreover, because "[s]etoff occupie[s] a favored position in our history of jurisprudence," *Bohack Corp. v. Borden, Inc.*, 599 F.2d 1160, 1164 (2d Cir. 1979), courts do not interfere with its exercise absent "the most compelling circumstances." *Niagara Mohawk Power Corp. v. Utica Floor Maintenance, Inc. (In re Utica Floor Maintenance, Inc.*), 41 B.R. 941, 944 (N.D.N.Y. 1984); *see also New Jersey Nat'l Bank v. Gutterman (In re Applied Logic Corp.)*, 576 F.2d 952 (2d Cir. 1978) ("The rule allowing

setoff ... is not one that courts are free to ignore when they think application would be unjust."). Compelling circumstances generally entail criminal conduct or fraud by the creditor. *In re Whimsy, Inc.*, 221 B.R. 69 (S.D.N.Y. 1998). No such compelling circumstances are present here, and accordingly, the Plan must provide for and preserve the federal government's setoff rights. Failure to do so violates section 1129(a)(1). ("The court shall confirm a plan only if . . . the plan complies with the applicable provisions of this title.")

11. The United States objects to the third party non-debtor injunction, exculpation and release provisions set forth in Article X of the Plan. The liquidating Debtors are not entitled to a discharge and yet the Plan currently provides for broad third party injunctions, exculpations and releases and provides no meaningful opportunity for non-voting creditors to opt out or consent. While the Third Circuit stopped short of adopting a *per se* rule that a non-debtor release in a reorganization plan is not permissible (as other circuits have done), it held that, at most, such a provision could only be valid in "extraordinary" cases. *Gillman v. Continental Airlines (In re Continental Airlines),* 203 F.3d 203, 212 (3d Cir. 2000). At minimum, *Continental* held that such a nonconsensual release of non-debtor entities must contain all of the following "hallmarks": "fairness, necessity to the reorganization, and specific factual findings to support these conclusions." *Id*. at 214*; see also In re Wash. Mut., Inc.*, 442 B.R. 314, 351-52 (Bankr. D. Del. 2011) (collecting cases). This Court has interpreted *Continental's* holding on non-debtor releases to mean that "limiting the liability of non-debtor parties is a *rare thing that should not be considered absent a showing of exceptional circumstances* in which several key factors are present." *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 608 (Bankr. D. Del. 2001) (emphasis added). This Court has previously held that a non-debtor release over a creditor's objection "would not pass muster." *Wash. Mut.*, 442 B.R. at 352 ("This Court has previously

held that it does not have the power to grant a third party release of a non-debtor."). When this Court contemplates approval of a non-consensual release, it requires debtors to satisfy the following factors to justify the "rare" release: "(1) the non-consensual release was necessary to the success of the reorganization, (2) the releases have provided a critical financial contribution to the Debtor's plan, (3) the releases' financial contribution is necessary to make the plan feasible, and (4) the release is fair to the non-consenting creditors, i.e., whether the non-consenting creditors received reasonable compensation in exchange for the releases." *In re Tribune Co.*, 464 B.R. 126, 177-78 (Bankr. D. Del. 2011); *see also Genesis Health Ventures*, 266 B.R. at 607-09. Here, setting aside whether the Debtors have made such a showing against all creditors generally (and they have not), Debtors make no adequate showing of a single factor, let alone all of the *Tribune/Genesis* factors, that justifies the extraordinary release of non-debtors with respect to their potential liability to the United States.

12. Moreover, the United States objects to the third party releases on the ground that the Bankruptcy Court cannot assert subject matter jurisdiction over unidentified claims. Thus, a proceeding solely between non-debtor parties based on non-bankruptcy law can only be heard by Bankruptcy Courts under "related to" jurisdiction, and then only "if the outcome could alter the Debtors' rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984); see *also Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.5, 115 S.Ct. 1493, 131 L.Ed. 2d 403 (1995) ("Proceedings 'related to' the bankruptcy include . . . suits between third parties which have an effect on the bankruptcy estate.")." Here, Debtors fail to specifically identify, much less establish Bankruptcy Court jurisdiction over, any of the transactions between the vast multitude of entities that are the Released Parties in the Plan.

In re Millennium Lab Holdings II, LLC, 242 F.Supp. 3d 322, 327(D. Del. 2017), *remanded to* 575 B.R. 252 (Bankr. D. Del. 2017), *appeal docketed*, No. 17-01461-LPS (D. Del. Oct. 17, 2017)

13. The United States objects to the Plan for imposing a settlement on the United States to which it has not consented. For example, the Plan provides:

> [P]ursuant to section 363 of the Bankruptcy Code and Bankruptcy Rule 9019 and in consideration for the distributions and other benefits provided under the Plan, on the Effective Date, the provisions of the Plan shall constitute a good faith compromise of all Claims and Interests and controversies relating to the contractual, legal and subordination rights that a Holder of a Claim or Interest may have with respect to any Allowed Claim or Allowed Interest, or any distribution to be made on account of such Allowed Claim or Allowed Interest. The entry of the Confirmation Order shall constitute the Bankruptcy Court's approval of the compromise or settlement of all such Claims, Interests, and controversies, as well as a finding by the Bankruptcy Court that such compromise or settlement is in the best interests of the Debtors, their Estates and holders of Claims and Interests and is fair, equitable and reasonable. In accordance with the provisions of the Plan, pursuant to section 363 of the Bankruptcy Code and Bankruptcy Rule 9019(a), without any further notice to or action, order, or approval of the Bankruptcy Court, after the Effective Date, the Plan Administrator may compromise and settle Claims against them and Causes of Action against other Entities.

[Plan, Article X.A].

14. The Debtors are attempting to "settle" without consent the unknown claims of unknown creditors without providing adequate notice. The United States has not been afforded an adequate opportunity to determine its claims or causes of action much less have such claims or causes of action be settled for an amount determined as sufficient in the Debtors' sole discretion. Moreover, the treatment and payment of claims under the Plan is the antithesis of settlement. Settlement is the consensual agreement between two or more parties to resolve a dispute. Here, the Plan hardly represents a consensual agreement between unknown federal creditors and the Debtors. By virtue of the Plan process, the United States does not waive

sovereign immunity and has not consented to the compromise or settlement of its claims or causes of action, and this provision is unfairly prejudicial to the rights of the United States.

WHEREFORE, the United States respectfully requests that the Court deny confirmation of the Debtors' Plan and grant such other and further relief as the Court deems necessary and just.

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Dated: July 23, 2018

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AFFIDAVIT OF SERVICE

I HEREBY CERTIFY that on July 23, 2018 a copy of the **OBJECTION BY THE UNITED STATES TO THE DEBTORS' MODIFIED JOINT PLAN OF LIQUIDATION** was served on the following in the manner indicated below:

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