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DISTRESSED OIL AND GAS ASSET SALES IN BANKRUPTCY: A PRIMER ON THE PROCESS FOR COUNSEL TO CREDITORS

Bruce White and Nora Pincus

The current oil and gas "bust" has raised a number of issues that counsel to creditors of distressed oil and gas exploration and production ("E&P") companies must be aware of, particularly as E&P companies are shedding assets, seeking forbearance agreements from creditors, and filing chapter 11 bankruptcy. E&P companies have always been prime candidates for chapter 11 bankruptcy for a number of reasons, including, but not limited to the cyclical commodity prices ($27 bbl oil or $2.00 kl gas will shake the financial foundations of even the proven E&P companies); the high cost of exploring and producing oil and gas; taking on too much debt; and the lure of high returns while overexposing the company to high levels of risk. These factors have led to a slew of chapter 11 filings by E&P companies in the past months, a trend that is expected to continue for the foreseeable future.

For the highly leveraged E&P company that has determined it does not have sufficient liquidity to fund a reorganization outside the bankruptcy courts, chapter 11 of the bankruptcy code can provide a means to complete a quick sale of some or all of the company's assets. A primary method to accomplish a "clean" asset sale under chapter 11 is through a so-called 363 sale. This references section 363 of the bankruptcy code, 11 U.S.C.§ 363, which allows the bankruptcy trustee or debtor-in-possession, with bankruptcy court approval, to sell some or all of the company's assets free and clear of liens, claims, and interests. The sale can either be accomplished under section 363(f) of the code or through a confirmed plan of reorganization, which incorporates a section 363 sale in the plan, but can also provide for the refinance or restructure of the company's debt and equity, if financially feasible, to allow the company to reorganize as a going concern.

A section 363 sale typically requires some form of competitive bidding, an auction of the assets or some form of exposure of the assets to the market in order to ensure fair value is being received. Two bankruptcy code sections are applicable in chapter 11 that explicitly authorize the sale of property. Section 363(b) authorizes a trustee (or debtor-in-possession) to sell property of the bankrupt estate outside the ordinary course of business with court approval. 11 U.S.C. § 363(b). Section 1123 of the bankruptcy code authorizes a chapter 11 plan to include a transfer or sale of all or any part of the property of the estate. 11 U.S.C. § 1123.

One of the benefits for distressed companies (and, arguably, drawbacks for creditors) of a sale of assets under section 363 is that it can be accomplished on an expedited basis. To accomplish the sale, the debtor must file a motion for authorization of the sale, which is typically filed on

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the first day of the case, and the bankruptcy court must hold a hearing on the motion. In evaluating whether to approve the 363 sale, most courts apply a “business judgment test,” under which the court will determine whether the sale makes sound business sense. This process generally takes in the range of 45 to 90 days to finalize.

If the asset sale is accomplished through a plan of reorganization, confirmation of a chapter 11 plan involves a more complicated and typically more time-consuming process. Under the reorganization process, creditors must be informed of the proposed plan and be given an opportunity to vote on whether to approve the plan. The reorganization process typically involves three steps: first, the debtor distributes a court-approved disclosure statement, which is similar to a prospectus, which provides creditors with information about the proposed plan so that creditors can make an informed decision in voting on the plan. Second, the creditors vote as to whether to accept or reject the plan of reorganization. Finally, if approved by the creditors or if the plan meets the section 1129 cram-down requirements, the debtor will seek a plan confirmation hearing wherein the bankruptcy court makes a determination of whether the plan meets the bankruptcy code requirements for confirmation. The full process can typically be 180 days or more.

As oil and gas prices continue to be highly volatile, we will no doubt see more and more E&P companies filing for bankruptcy protection and more assets sold through the 363 sale process. If you are representing a secured creditor or a mechanic lien holder of a distressed E&P company seeking a forbearance on the debt, it is extremely important as part of any forbearance to do a complete loan review and make sure your client’s security interest or lien is properly perfected at least 90 days before any bankruptcy filing happens. When a bankruptcy filing takes place, counsel to creditors must pay close attention to the motions filed because the process moves quickly and your client’s rights could be negatively impacted by a failure to timely object.

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OLD QUIET TITLE MAKING NEW RACKET

Bruce F. Rudoy and Steven B. Silverman

The growth of the U.S. economy in recent decades, along with contemporaneous expansion in industrialization and energy use abroad, has caused an explosion in demand for oil and natural gas. During that same time, oil and natural gas exploration and production companies have innovated new methods and techniques for extracting natural resources that were once considered inaccessible. New geologic reserves of hydrocarbons are being discovered at a rapid pace and the ability to develop new reserves has improved dramatically.

A decade or more ago, a person purchasing real estate might not even consider researching the ownership of the oil, gas, and minerals underneath his or her property. Now, cognizant of new drilling techniques and the boom in hydraulic fracturing of shale deposits, that same person will likely be eager to determine subsurface ownership. After all, oil and gas producers can now extract the oil and gas under a property from a well site located miles away, causing little or no impact to the surface.

A landowner can become disappointed to learn that the ownership of an oil and gas estate has been severed from the surface, sometimes more than a century in the past. The current record oil and gas owners may be unknown, may all be deceased, or may be unlocatable.

Sensing an opportunity to profit from the true owners' absence, a surface landowner may turn to an attorney to determine what action he might take to reacquire the oil and gas estate. In some instances, where a mere cloud on title exists, it is appropriate to institute a legal action to remove the cloud on title, called an "action to quiet title." A cloud might consist of an ambiguous reservation in a deed or an improper description of the interest being conveyed. However, unless the surface owner has some color of title by which to claim the oil and gas, a quiet title action is an improper mechanism to reacquire the subsurface estate and can be fraught with risk.

The biggest risks for an attorney pursuing a quiet title action on behalf of a surface owner include professionally managing and ethically satisfying the client's expectations. A surface owner with no true claim to the oil and gas would presumably prefer that the dispersed heirs of the severed oil and gas estate not be found. But an attorney seeking to satisfy a surface-owner client's unreasonable expectations to reunite the oil and gas to which the client has no claim can find him- or herself running afoul of constitutional issues that have recently come to the forefront of oil and gas law.

In 2015, the Pennsylvania Superior Court, an intermediate appellate court, twice addressed constitutional due process issues raised as a result of imperfectly handled quiet title actions involving severed Marcellus shale-region oil and gas. *Northern Forests II, Inc. v. Keta Realty Co.*, 130 A.3d 19 (Pa. Super. Ct. 2015); *Sisson v. Stanley*, 109 A.3d 265 (Pa. Super. Ct. 2015).

Sisson involved the oil and gas underlying 98.5 acres. In 1953, Joseph Stanley conveyed the tract to Pauline Battista, reserving oil and gas. In 1986, Ms. Battista conveyed the parcel to Donald and Mary Sisson, subject to the same reservation. In 2010, the Sissons sought to quiet title to Stanley's oil and gas, to which they had no color of title. They named as defendants Joseph Stanley, his heirs, successors, executors, assigns, and any person claiming by, through, or from them. Their attorney sought to serve notice of process by publication, which requires an affidavit setting forth the nature and extent of the investigation made to determine the whereabouts of the defendants and why personal service cannot be made.

The trial court granted the motion for service by publication, and when no interested party came forward to defend the action, granted final judgment in default in favor of the Sissons on August 2, 2010.

Three months later, Rita Stanley Lupold came forward, claiming to be the then-deceased Joseph Stanley's sole surviving sibling. She filed a petition to open the judgment, alleging that the Sissons had failed to effect proper service. The trial court agreed with her, and ultimately granted a motion for judgment on the pleadings in her favor.

The Sissons appealed, arguing that opening judgment in this case cast doubt on every quiet title judgment where service of process was made by publication. On appeal, the Superior Court noted that service of process is not a mere technicality, but rather a constitutional requirement. The court focused on the sufficiency of service, explaining that service by publication is an "extraordinary measure" and can only be applied where service cannot be made "in the normal fashion."

The court then dissected the attorney's affidavit in support of the Sissons' motion for service by publication, which it characterized as "skeletal." In it, the attorney swore that he had been unsuccessful in his attempts to locate the defendants, having searched the public records of the local recorder of deeds, local telephone directories, and "various internet sites for the names and possible locations of the named Defendants."

Finding numerous deficiencies in the affidavit, the court held it to be inadequate, highlighting for instance that the affidavit "does not indicate in any manner that a relevant search was performed to locate any wills or other probate records. . . . Had this been done, counsel would have found, as the trial court noted, the will of E. J. Stanley, Joseph's father, which identified no fewer than twelve siblings to Joseph."

It should be noted that the Susquehanna County, Pennsylvania Recorder of Deeds (where the land was located)—which the attorney had purportedly searched—and the Register of Wills share an office, and are both located within the courthouse.

In rejecting the Sissons' arguments and affirming the trial court judgment in favor of Ms. Lupold, the court signaled its awareness of the broader impact and financial motivations of modern drilling: "Given the current climate to find and secure properties for gas exploration in the Marcellus Shale formation in Pennsylvania, it would not be unexpected to see many more attempts like those made by [the Sissons] here to challenge property rights for the profit to be made in this industry."

Recognizing the due process rights inherent in a deprivation of property rights, the court stated that "it is imperative that courts be vigilant to ensure that good faith efforts are properly scrutinized, documented and verified before authorizing service by publication."

It is not certain, however, what the outcome of this case would have been had default judgment been entered prior to 1986. Prior to that year, the affidavit in support of alternative service was not required to set forth the efforts made to locate the defendants; only that they were dead or their whereabouts unknown. Moreover, a petition to open judgment, as filed in *Sisson* and as contrasted with a motion to strike, must be timely filed.

In *Northern Forests*, decided 11 months later, the same court partially answered the question of whether it would look further back in time to *strike* a default judgment based on the sufficiency of service by publication. That case involved a final judgment entered in 1989 vesting the oil and gas estate in Northern Forests II, Inc. The affidavit in support of Northern Forests' motion for alternative service provided only that the attorney "does not know the current whereabouts of the defendants, and the principals of the corporate entities are unknown, and he does not know any successors or assigns of the above or anyone claiming by, through or under them, or any of them."

More egregious was that the named defendants to the 1989 quiet title action included only the surface owners. Northern Forests had not named the heirs and assigns of the severed subsurface estate as defendants. Thus, the subsurface estate owners were calculated to have *never* received service.

In 2012 and 2013, several successors to the unnamed oil and gas owners petitioned to open or strike the judgment, arguing that indispensable parties had not been joined to the original action, and that the attorney's affidavit in support of the motion for alternative service to that action was inadequate.

The trial court agreed, and struck the original judgment, but permitted Northern Forests to file an amended complaint to quiet title. Northern Forests accepted the invitation and refiled, naming more than 90 defendants. The defendants responded by asserting that Northern Forests had failed to state a cause of action, an argument that was accepted by the trial court. Northern Forests appealed.

The superior court found two jurisdictional defects sufficient to strike the 1989 judgment: failure to join indispensable parties, and lack of proper service on any defendant to the original action. The court again dug into the affidavit in support of the motion for alternative service, quoting its *Sisson* decision at length, and found that the affidavit here was even more deficient. "[C]ounsel's affidavit totally failed to describe what efforts he made to discover the whereabouts of any person holding an interest in the Property."

In an attempt to save the 1989 judgment from its constitutional deficiencies, Northern Forests argued that equitable considerations precluded striking it. Many parties had relied upon that judgment to conduct business during the intervening years. The Court was unpersuaded: "Unlike fine wine, void judgments in Pennsylvania do not become better with age; void *ab initio*, void for all time."

In New Mexico, a mid-level appellate court also addressed the efficacy of an action to quiet title. In 2014, the court vacated a summary judgment that upheld a 1948 order quieting title. *T.H. McElvain Oil & Gas L.P. v. Benson-Montin-Greer Drilling Corp., Inc.*, 340 P.3d 1277 (Ct. App. N. Mex. 2014). In that case, dealing with 160 acres in the San Juan basin, home to the Lewis and Manco shales in northern New Mexico, the subsurface estate was severed by a 1928 deed that "except[ed] and reserve[ed] . . . the oil and gas. . . ."

In 1931, David Miller, the surface owner, quitclaimed his interest to his brother, Thomas Miller. In 1948, Thomas Miller sought to quiet title to the oil and gas, naming the grantors to the 1928 deed as defendants. Default judgment was entered in his favor after service by publication in a New Mexico newspaper. His complaint had included a sworn affidavit from his attorney who provided that Miller had been unable to learn or determine the names or places of residences of any heirs to the grantors, "after diligent search and inquiry." Further, the sheriff's return indicated that the heirs were unable to be located in San Juan County, New Mexico.

However, the record made clear that it would not have been difficult to locate the grantors and their heirs. The 1928 deed reflected that the grantors resided in San Diego, California, at the time of the conveyance. A title search would have easily revealed this information. Further, a search of the San Diego city directory contemporaneous with the 1928 deed would have identified the residence at which one of the grantors and her heir lived through and after the date of the 1948 quiet title action.

As a result of the deficiencies in the search, the court of appeals held that the oil and gas owners did not receive constitutionally adequate notice of the 1948 quiet title action. The court vacated the grant of summary judgment entered by the trial court in favor of the successors to Thomas Miller, and remanded for further proceedings. Nevertheless, the case was appealed to the New Mexico Supreme Court, where it presently awaits adjudication.

The root issue in all of these cases is the constitutional due process question. The deprivation of property without adequate notice and due process has concerned each of the courts involved, and has allowed them to overturn default judgments that, in two of the cases, had been of record for decades, and have incurred substantial reliance by dozens of parties. The caption for *Northern Forests*, for example, runs almost four full pages.

Owing to the constitutional issues and the sums of money involved in new exploration, reliance on a default quiet title judgment raises risk that the judgment could be stricken or reopened, even decades later. An attorney asked to pass on quiet title might consider determining whether the quiet title judgment was by default or contested before passing on title, and parties relying on such judgments should beware that they might not be quite so quiet, after all.

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DE FACTO PARTNERSHIPS IN TEXAS: DO ACTIONS ALWAYS SPEAK LOUDER THAN WORDS?

Ileana Blanco and Chris Schaeper

As a matter of law, do actions always speak louder than words? Can parties ever agree in advance that their written agreement will never be changed by their subsequent conduct? A Texas case currently pending before the Fifth Court of Appeals, Dallas, *Enterprise Products Partners L.P. v. Energy Transfer Partners, L.P.* (No. 05-14-01383-CV), is seeking answers to this question, at least in the partnership context. Regardless of the ultimate outcome, the case offers some possible lessons for greater focus on the pre-definitive documentation stage of any transaction, regardless of deal size or sophistication of the parties.

Enterprise and ETP are both large Texas-based midstream companies. In 2011, Enterprise saw a market opportunity to help ease the Cushing, Oklahoma, bottleneck as production from Canada and the Midwest pushed more oil into the system from the north, and reduced exports pushed less oil from the Gulf Coast. The economical answer was to find an existing pipeline network and either modify it to handle oil or reverse the direction of the flows. Enterprise approached ETP to use its northbound Old Ocean pipeline, converting it from natural gas to oil and extending it from Dallas to Cushing. In March-April 2011, they signed a series of documents typical at this stage of negotiations: a mutual confidentiality agreement (NDA) to maintain the secrecy of information exchanged between them; a term sheet (LOI) outlining high-level terms of what the Enterprise-ETP joint venture might contain; and a letter agreement to provide for their reimbursement of engineering costs incurred in exploring project feasibility (reimbursement agreement).

After four months, Enterprise determined that the Old Ocean line was not commercially viable and terminated the discussions. Enterprise subsequently entered into a venture with Enbridge over its Seaway pipeline, which ultimately proved successful. ETP sued Enterprise, claiming that they had a partnership to develop Old Ocean and that by dropping ETP and moving forward with Enbridge, Enterprise violated its fiduciary duties. Recognizing that it had a statute of frauds problem in claiming that it had a partnership to construct and operate Old Ocean (given that a pipeline could not be constructed within one year), ETP amended its claim to allege that the partnership was to market and pursue a pipeline, and that is the claim that went to the jury. ETP also sued Enbridge for conspiracy, but the jury ultimately exonerated it.

The jury found that a partnership indeed existed between Enterprise and ETP, awarding it $319 million in actual damages and $595 million in disgorgement damages against Enterprise for breaching its partnership duty of loyalty. The court entered judgment, reducing the disgorgement damages to $150 million, resulting in a total award of $535 million when including pre-judgment interest. Claiming "partnership by ambush" in a result that ignored the parties' written agreements, Enterprise appealed to the Fifth Court of Appeals in Dallas. Oral argument was heard on April 21, 2016, and a decision is expected in the next several months.

Enterprise argues that the lower court's decision is an assault on freedom of contract, creating uncertainty in an industry when stability is prized. The preliminary documents signed by the parties would be familiar to anyone working on joint ventures in the oil patch. The term sheet was expressed as "non-binding," disclaiming "any binding or enforceable obligations between the Parties." Accordingly, either party could, for any reason, "depart from or terminate the negotiations . . . without liability or obligation." The NDA similarly disclaimed "any legal obligation of any kind whatsoever with respect to any transaction by virtue of [the NDA] or any written or oral expression." Even the reimbursement agreement expressly disclaimed any joint venture or partnership between the parties. With such strong language, what could go wrong?

According to ETP, it's what they did afterward that counted. Under the five factors in Texas Business Organizations Code § 152.052 adopted from prior law, partnerships can be created by the parties' conduct absent a written agreement to form one: (1) the receipt or right to receive a share of the profits of the business (here, agreeing to share expenses under the reimbursement agreement and ultimately sharing profits when the pipeline became operational); (2) expression of an intent to be partners in the business (issuing press releases characterizing their project as a joint venture and regarding each other as partners; sending e-mails and saying in meetings that they were partners); (3) participation or right to participate in control of the business (jointly preparing marketing materials, setting rates, negotiating third-party agreements); (4) agreement to share or sharing of losses, or liability for claims by third parties against the business, and (5) agreement to contribute or contributing money or property to the business (contributing capital to the project, including the "sweat equity" of their personnel). Not all five factors had to be met to support the jury's finding that a partnership existed. And it is not the subjective intent of the parties to form a partnership that is critical, but the expression of an intent.

A key issue likely to be addressed by the court of appeals is whether a partnership could have been formed even though the LOI, NDA, and reimbursement agreement expressly imposed conditions to the transaction which went unmet: execution of definitive documentation and board approval. An older Texas case, *Root v. Tomberlin*, 36 S.W.2d 596 (Tex. Civ. App.–El Paso 1931, writ ref'd), holds that if the parties impose a condition to formation of a partnership (in that case, execution of a joint operating agreement), no partnership will come into being until that condition has been met. A more recent decision, *Thompson v. Thompson*, 500 S.W.2d 203 (Tex. Civ. App.–Dallas 1973, no writ), discussed at oral argument in this case, holds that conditions precedent do not control, and may be waived if the parties actually proceed with the business of the partnership. That case involved a timing issue as to when the partnership came into existence for purposes of a marital property division. Tax returns had been filed showing sharing of losses in a partnership prior to the divorce decree, but a condition precedent (deeding the property into the partnership) occurred post-divorce. The court held that the deed condition had been waived by treating the partnership as in existence for tax purposes. Enterprise concedes that conditions can be waived but the parties differ on who had the burden to prove waiver and whether that burden was met.

The parties here did express an intent to form a legal entity, but a limited liability company (LLC) rather than a partnership. The premise must have been that Enterprise and ETP intended to form an LLC per their LOI and then decided, by their actions, to reject the LLC form and instead form a general partnership with broad fiduciary duties and unlimited liability to third parties (which rarely happens in the energy industry). The irony is that had the parties signed definitive documentation upfront and dispensed with the LOI, ETP almost certainly would have had no case, as the fiduciary duties supporting ETP's claim either do not exist with LLCs or are commonly disclaimed in written LLC agreements.

Much has been written about precautions that parties can take in light of the district court's outcome, including not referring to each other as partners; refraining from agreeing to share profits/losses or make contributions until definitive agreements are signed; and waiving the right to assert the existence of a partnership. Even ETP in its brief said that Enterprise could have insisted on a "no oral modifications" clause in the LOI but didn't. While these are all good thoughts, they raise the existential question as to whether any contractual language can trump the parties' subsequent conduct. Texas has long held that a written agreement not required by law to be in writing may be modified by a later oral agreement, even though it provides that it can be modified only in writing. *Double Diamond v. Hilco Elec. Coop.*, 127 S.W.3d 260, 267 (Tex. App.–Waco 2003, no pet.). We can all counsel our clients not to do things like refer to one another as "partners" or share expenses, etc., but sometimes those things happen anyway. What are we left with, if whatever is signed can later be undone by a stray e-mail or "off the record" discussions in a conference room?

Two things come to mind. *First*, consider stretching the customary "no oral modifications" and "no course of dealing" clauses to go one step further, by imposing upon each party an affirmative duty to promptly inform the other party if that party believes that any discussions or course of dealing has altered the non-binding nature of their relationship (notwithstanding the disclaimers). This goes to the "partnership by ambush" issue raised by Enterprise, designed to prevent sandbagging. Arguably, such a covenant imposes an advance estoppel argument, or could be the basis for a breach of contract claim against a party seeking to impose a de facto partnership, and possibly could form the basis for a fraud claim.

Another more conventional approach would be to expressly provide for the law of a state other than Texas to govern (Texas law was designated to govern the NDA and reimbursement agreement, and the LOI was silent). Delaware would be a rationale choice, as it is often the preferred jurisdiction of formation of LLCs, and Delaware has a well-developed body of law governing such entities. At least one Delaware chancery court has considered the issue in a case with remarkably similar facts, where the parties agree to form an LLC for a swimming pool venture. *Ramone v. Lang*, No. Civ. A. 1592-N, 2006 WL 905347 (Del. Ch. Apr. 3, 2006). There, the court reached an opposite conclusion, finding no de facto partnership: "To consider Ramone and Lang partners would make it hazardous for businesspersons to agree to negotiate the formation of an LLC together without risking a judicial declaration that they thereby created a *de facto*, informal partnership if their negotiations fail. The mere fact that Lang colloquially used the word 'partners' publicly at certain meetings and in certain documents does not overcome, as between Ramone and Lang, their inability to establish a binding, business relationship by contract."

Whether the lower court's decision in *ETP v. Enterprise* remains good law will probably not be known for some time. The opinion of the Fifth Court of Appeals in Dallas likely will take several months, and we should expect the losing party to appeal to the Texas Supreme Court. Until this state's highest court has decided the issue, uncertainty remains. Regardless of the outcome, parties everywhere are forewarned to take another look at how they prepare and negotiate their pre-definitive documentation for transactions of all types.

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LOUISIANA, FUNDED BY OIL AND GAS[1]

Tyler Gray

The drop in the price of oil over the past 18 months affects more than just operators, the consumer, and the Middle East. It affects domestic state governments that rely heavily on oil and gas for their budget. In Louisiana (the "state"), each dollar change in the price of oil results in a $12 million difference in its budget. For over a century, there has been a strong relationship in Louisiana between mineral income and government. Today, only 12 percent of Louisiana's tax base relies on direct mineral income, but for many years that percentage was much higher. Yet despite this reduced reliance, Louisiana and the federal government still count on mineral revenue, but it is not always clear how it gets there because it comes from direct and indirect sources. For Louisiana, revenue from oil and gas can come directly from upstream and indirectly from downstream sources, which is true for the federal government as well. This will focus on the nuisances of the Louisiana state system, but there are a few similarities at the federal level, which will be noted because these funds ultimately trickle back down to Louisiana.

How does Louisiana get direct revenue from the upstream sector of the oil and gas industry? Louisiana receives direct funding from three difference sources, (1) mineral revenue, (2) severance taxes, and (3) fees. First, mineral revenue is derived from bonus payments and royalties from lease sales. Through the Department of Natural Resources, Office of Mineral Resources, the state hosts a monthly lease sale. At these lease sales, the state auctions leases on designated tracts of state lands for operators to bid on. Once a winner is confirmed, the bid is called a "bonus payment," which is paid to the state and the operator is granted a lease. Established in the lease, the operator pays royalties to the state based on production. Traditionally, this is the second biggest revenue generator for the state, generating $3.1 billion in royalty revenue alone since 2009.

Unfortunately for Louisiana, the price of oil has affected leasing activity on state lands. With decreased activity in leasing state lands, royalty payments to the state drop. In fact, the amount paid on royalties has decreased every month since May of 2015. And, the lease sale in July of 2016 only generated $59,150 in bonus payments, granting two leases covering 294 acres, located in Calcasieu and Plaquemines parishes. While these leases have generated $5.5 million in fiscal year 2016, this is far less than in 2014. The March lease sale alone generated $769,753 in bonus payments, granting 9 leases covering 2153 acres, which is 15 percent of the total revenue in 2016 collected in one month. In fiscal year 2014, the state collected over $14.7 million in revenue. This reduction has led to a budget deficit; in fact, the Louisiana legislature was forced to increase revenue by passing new sales taxes in a 2016 special session because of the drop in the price of oil.

Similarly, the federal government will put up tracts of land in the Gulf of Mexico through lease sales, which operators can bid on. The winning bidder is granted a lease in which it will pay royalties, and the bonus payment, to the federal government. Since 2009, oil and gas operators have put over $44 billion dollars into federal coffers through bonus payments and production royalties. While it has taken many years, there is revenue coming back to the state of Louisiana as part of this program. Through the Gulf of Mexico Energy Securities Act (GOMESA), signed into law on December 20, 2006, leasing revenues will be shared with four oil- and gas-producing states, including Louisiana, with funds to be used for coastal conservation, restoration, and hurricane protection. GOMESA allocates $375 million dollars to the Gulf States in 2017, and Louisiana will get $176 million of it. While the funds generated from oil- and gas-leasing activities does not directly go to Louisiana's state budget, it is allocated through the federal government, ultimately reaching Louisiana, and the program itself is very similar to Louisiana's leasing program of state lands.

Second, oil and gas provides revenue to Louisiana's state budget through severance tax. Operators extracting oil and gas must pay a tax to the state of Louisiana for severing its natural resources from the ground. The first tax based on the severance of oil was imposed in 1910. This tax was levied as an occupational license tax at a rate of 2/5¢ per barrel of oil. Since 1910, there have been many changes in the tax rates including fluctuations from a volumetric to a percentage-of-value based tax. Today, operators must pay a volume-based tax on oil at 12.5 percent per barrel, which is currently the highest in the country. For gas, the rate on severance of gas fluctuates year to year. In fiscal year 2016, the rate is 15.8 cents per million cubic feet. Severance on oil and gas is a big revenue generator for the state, specifically producing totals of $861.2 million (2013), $833.38 million (2014), and $549.26 million (2015). The coastal zone[2] generates the largest portion of severance tax on oil. Since 2009, the coastal zone has generated more than $2.9 billion dollars in severance on oil alone. To give you a comparison of the severance revenue generated on gas in the coastal zone, Louisiana has received only $429.8 million dollars since 2009. But, keep in mind a majority of the severance on gas is paid from the northwest region (Haynesville shale) of the state. Regardless of where these sums come from geographically, this is a significant sum in which the upstream sector deposits directly into the state of Louisiana's treasury.

The final direct funding source for Louisiana is the fees oil and gas operators must pay on permits issued by regulating authorities. In Louisiana, an oil and gas operator must pay a fee to the Department of Natural Resources, Office of Conservation, which is the primary permitting authority, but must also hold a permit(s) from the Department of Environmental Quality as it relates to air. While these fees are insignificant individually, the regulatory authorities are fully funded by the regulated community. This is significant because these agencies are not funded by private citizens or taxpayers. State regulatory agencies are fully funded by the regulated community, specifically oil and gas.

In Louisiana, upstream oil and gas operators directly fund a significant portion of the state budget. Not only does Louisiana derive funds from severance tax, royalties, and bonus payments, but the necessary regulatory authorities are also fully funded by the regulated community. Therefore, the funds generated by severance, royalties, and bonus payments can be used for other functions of the state. But, the flow of revenue from oil and gas into state coffers does not end with direct sources. Louisiana derives revenue from indirect sources as well, which includes property taxes on oil and gas equipment, sales tax, and corporate income taxes. The exploration for minerals is an important revenue source for the state of Louisiana, along with the rest of the nation.

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Endnotes

1 All data referenced in this essay are publicly available through the Technology Assessment Office of the Department of Natural Resources and can be found at http://dnr.louisiana.gov.

2 Originally established by the Coastal Zone Management Act of 1978, the coastal zone is an environmentally sensitive area consisting of 19 parishes. To operate in the coastal zone, an operator must have an approved permit from the Department of Natural Resources, Office of Coastal Management.