

# Oklahoma Law Review

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Volume 70 | Number 3

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2018

## Drilling When the Well Goes Dry: The Oklahoma Corporation Commission & the Police Power Exception to the Automatic Stay

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### Recommended Citation

Connor R. Bourland, *Drilling When the Well Goes Dry: The Oklahoma Corporation Commission & the Police Power Exception to the Automatic Stay*, 70 OKLA. L. REV. 699 (2018), <https://digitalcommons.law.ou.edu/olr/vol70/iss3/5>

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## COMMENTS

### Drilling When the Well Goes Dry: The Oklahoma Corporation Commission & the Police Power Exception to the Automatic Stay

#### *Introduction*

The oil and gas industry is, for all intents and purposes, the lifeblood of the Oklahoma economy. Everywhere you turn, you see another oil pump. Some bob up and down as they draw the “cash crop” of Oklahoma from the shale formations thousands of feet below. Others appear lifeless and have not moved in years. You see them beside the interstate, next to family farms, in the middle of empty fields, and even in and around the state’s largest cities. Nearly every facet of life in Oklahoma is in some way affected by the oil and gas industry. The energy industry in Oklahoma employs the state’s largest workforce—nearly 200,000 people.<sup>1</sup> The population increase in the state is directly tied to the success of the oil industry.<sup>2</sup> Even the state’s tallest building and focal point of the downtown Oklahoma City skyline, the Devon Energy Center, is home to thousands of oil and gas industry employees.<sup>3</sup> Furthermore, the price of a barrel of oil drastically affects the state’s gross domestic product,<sup>4</sup> funding for education,<sup>5</sup> and even charitable giving.<sup>6</sup>

Given the importance of oil and natural gas to the state, it should come as no surprise that the sharp drop in oil prices in 2014 hit Oklahoma’s economy particularly hard, especially in the job market.<sup>7</sup> With the layoffs

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1. *Energy*, OKLA. DEP’T OF COMMERCE, <http://stateofsuccess.com/industries/energy> (last visited Feb. 7, 2017).

2. MARK C. SNEAD & AMY A. JONES, STATE CHAMBER OF OKLA. RESEARCH FOUND., *ECONOMIC IMPACT OF THE OIL & GAS INDUSTRY ON OKLAHOMA* 48 (Sept. 2016), <http://www.okstatechamber.com/files/OK%20Oil%20and%20Gas%20Tax%20Policy%202016%20Final.pdf>.

3. DEVON ENERGY CENTER, <http://devonenergycenter.net> (last visited Feb. 8, 2017).

4. See SNEAD & JONES, *supra* note 2, at 3.

5. Luc Cohen & Joshua Schneyer, *Taxing Lessons: When the Oil Boom Went Bust, Oklahoma Protected Drillers and Squeezed Schools*, REUTERS INVESTIGATES (May 17, 2016, 1:37 PM), <http://www.reuters.com/investigates/special-report/usa-oklahoma-bust>.

6. Steve Lackmeyer & Adam Wilmoth, *Oklahoma City Shares Pain Being Felt as Spending Cuts and Layoffs Continue at Chesapeake Energy*, OKLAHOMAN (Sept. 29, 2015, 12:00 AM), <http://newsok.com/article/5450268>.

7. See Associated Press, *Low Oil Prices Force 2 Oklahoma Companies to Cut Jobs*, FUEL FIX (Mar. 27, 2015), <http://fuelfix.com/blog/2015/03/27/low-oil-prices-force-2->

came the inability of oil companies across North America to pay off their many creditors: since the beginning of 2015, 134 exploration and production (E&P) companies in North America filed for bankruptcy, with approximately \$79.8 billion in cumulative debt.<sup>8</sup> In 2016 alone, seventy E&P companies filed bankruptcy with \$56.8 billion in cumulative debt.<sup>9</sup> To make matters worse, E&P companies have not borne the hardship alone: 155 oilfield service companies (\$43.6 billion in cumulative debt)<sup>10</sup> and twenty-one midstream companies (\$20.3 billion in cumulative debt) have also filed for bankruptcy since 2015.<sup>11</sup>

In addition to the dramatic impact on the state's economy, bankruptcies of E&P companies in Oklahoma could have an interesting effect on the

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oklahoma-companies-to-cut-jobs (Worthington Industries and Samson Resource Co. layoffs); Keaton Fox, *Another OKC-Based Oil and Gas Company Announces Layoffs*, FOX 25 (Feb. 25, 2016), <http://okcfox.com/news/local/another-okc-based-oil-and-gas-company-announces-layoffs> (Kimray, Inc., layoffs); Brian Hardzinski, *Layoffs Coming for Oklahoma City-Based Devon Energy*, KGOU (Jan. 21, 2016), <http://kgou.org/post/layoffs-coming-oklahoma-city-based-devon-energy>; Zak Patterson, *Chesapeake Energy Lays Off 562 Oklahoma City Employees Tuesday*, KOCO NEWS 5 (Sept. 29, 2015, 10:28 PM), <http://www.koco.com/article/chesapeake-energy-lays-off-562-oklahoma-city-employees-tuesday/4306186>; Rod Walton, *Oil Bust Hits Home: Apache Corp., Others Cutting Jobs in Tulsa Area*, TULSA WORLD, Jan. 17, 2015, [http://www.tulsaworld.com/business/energy/oil-bust-hits-home-apache-corp-others-cutting-jobs-in/article\\_fcce8e3d-99e2-582b-8b35-09dd99346d15.html](http://www.tulsaworld.com/business/energy/oil-bust-hits-home-apache-corp-others-cutting-jobs-in/article_fcce8e3d-99e2-582b-8b35-09dd99346d15.html); Adam Wilmoth, *Energy Company Announces Layoffs in Oklahoma City*, OKLAHOMAN (Sept. 26, 2014), <http://newsok.com/article/5345671> (HighMount Exploration and Production LLC layoffs). The economic impact of the energy industry layoffs has also affected other Oklahoma industries. Lacie Lowry, *Oil Field Cuts, Layoffs Trickling Down to Other Industries*, NEWS 9 (Oct. 19, 2015 5:45 PM), <http://www.news9.com/story/30300350/oil-field-cuts-layoffs-trickling-down-to-other-industries>.

8. HAYNES AND BOONE, LLP, OIL PATCH BANKRUPTCY MONITOR 2 (Oct. 31, 2017), [http://www.haynesboone.com/~media/files/energy\\_bankruptcy\\_reports/2017/2017\\_oil\\_patch\\_monitor\\_20171031.ashx](http://www.haynesboone.com/~media/files/energy_bankruptcy_reports/2017/2017_oil_patch_monitor_20171031.ashx) [hereinafter OIL PATCH BANKRUPTCY MONITOR]. This number reflects only the bankruptcies of E&P companies and does not include midstream companies or oilfield service companies. Haynes and Boone updates its *Oil Patch Bankruptcy Monitor* fairly regularly, and the number of bankrupt E&P companies and their cumulative debt will frequently change.

9. *Id.* at 8–9.

10. HAYNES AND BOONE, LLP, OILFIELD SERVICES BANKRUPTCY TRACKER 2 (Oct. 31, 2017), [http://www.haynesboone.com/~media/files/energy\\_bankruptcy\\_reports/2017/2017\\_ofs\\_bankruptcy\\_tracker\\_20171031.ashx](http://www.haynesboone.com/~media/files/energy_bankruptcy_reports/2017/2017_ofs_bankruptcy_tracker_20171031.ashx). Like the *Oil Patch Bankruptcy Monitor*, Haynes and Boone frequently updates its *Oilfield Services Bankruptcy Tracker*.

11. HAYNES AND BOONE, LLP, MIDSTREAM REPORT 2 (Oct. 31, 2017), [http://www.haynesboone.com/~media/files/energy\\_bankruptcy\\_reports/2017/2017\\_midstream%20report\\_20171031.ashx](http://www.haynesboone.com/~media/files/energy_bankruptcy_reports/2017/2017_midstream%20report_20171031.ashx). Like the *Oil Patch Bankruptcy Monitor*, Haynes and Boone frequently updates its *Midstream Report*.

workings of the Oklahoma Corporation Commission (“Corporation Commission”).<sup>12</sup> Specifically, bankruptcy could impact the processes by which E&P companies (and even individual working interest owners) obtain permission to drill wells in Oklahoma. There are over 3000 oil well operators registered with the Corporation Commission.<sup>13</sup> Of those operators, at least thirteen major E&P companies have filed for bankruptcy since 2015: Sabine Oil & Gas, Continental Exploration, Samson Resources, Osage Exploration and Development, New Source Energy Partners, Postrock Energy, Midstates Petroleum, Chaparral Energy, Linn Energy, Penn Virginia, Breitburn Operating, SandRidge Energy, and Atlas Resource Partners.<sup>14</sup> The safe haven of bankruptcy offers these debtors protections from existing and would-be creditors, chiefly the § 362(a) automatic stay.<sup>15</sup> The automatic stay shields a debtor in bankruptcy from the initiation or continuation of judicial proceedings brought against the debtor.<sup>16</sup> There are, however, exceptions to the automatic stay.<sup>17</sup> Among those exceptions is the “police power exception.”<sup>18</sup> The police power exception allows governmental units to exercise their police and regulatory authority—under certain circumstances—despite the protection of the automatic stay.<sup>19</sup> The question becomes: How does this exception to the automatic stay impact the conservation proceedings of the Corporation Commission?

The Corporation Commission recently considered this question as it related to Linn Energy, an E&P company based in Houston, Texas, with

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12. The Oklahoma Corporation Commission is discussed *infra* Part I.

13. See generally OKLA. CORP. COMM’N, OPERATOR’S DIRECTORY (Dec. 15, 2017) (on file with the *Oklahoma Law Review*).

14. Compare *id.* at 29 (Atlas Resources), *id.* at 70 (Breitburn Operating), *id.* at 103 (Chaparral Energy), *id.* at 126 (Continental Exploration), *id.* at 318 (Linn Energy), *id.* at 351 (Midstates Petroleum), *id.* at 406 (Penn Virginia), *id.* at 473 (Sabine Oil & Gas), *id.* at 476 (Samson Resources), and *id.* at 477 (SandRidge Energy), with OIL PATCH BANKRUPTCY MONITOR, *supra* note 8, at 7–9. While not listed in the Operator’s Directory, both Postrock Energy and Osage Exploration and Development filed their respective bankruptcies in the Western District of Oklahoma. OIL PATCH BANKRUPTCY MONITOR, *supra* note 8, at 8. Following its liquidation in a Chapter 7 bankruptcy, New Source Energy Partners is no longer listed in the Operator’s Directory. Adam Wilmoth, *New Source Energy Declares Bankruptcy*, OKLAHOMAN (March 18, 2016), <http://newsok.com/article/5485645>.

15. 11 U.S.C. § 362(a) (2012).

16. *Id.* § 362(a)(1).

17. See generally *id.* § 362(b).

18. *Id.* § 362(b)(4).

19. *Id.*

operations in Oklahoma.<sup>20</sup> Mid-Continent II, LLC, a subsidiary of Linn Energy, was serving as the operator of wells in two different established spacing units when Linn Energy filed a petition for Chapter 11 bankruptcy on May 11, 2016.<sup>21</sup> Less than a month later, Gaedeke Oil & Gas Operating, LLC, owner of more than fifty percent of the working interest in each unit, asked the Corporation Commission to modify or vacate the pooling orders and name Gaedeke the operator of the wells instead of Linn Energy.<sup>22</sup> At the hearing for Gaedeke's motion on June 27, 2016, the Administrative Law Judge raised a concern about the impact of the automatic stay on the proceedings.<sup>23</sup> Gaedeke argued the proceeding should continue despite the automatic stay because of the police power exception.<sup>24</sup> Judge Decker agreed,<sup>25</sup> and the Commissioners upheld the decision, finding that the proceeding to re-open the pooling order fell within the police power exception.<sup>26</sup>

Considering the Corporation Commission's decision that pooling proceedings should be excepted from the automatic stay, it is important for Oklahoma practitioners to understand how the police power exception and the automatic stay function. Part I of this Comment discusses forced poolings, the conservation proceeding before the Corporation Commission arguably most impacted by the automatic stay and the police power exception. Part II explores the purpose and elements of the automatic stay and its role as protector of the bankruptcy estate. Part III explores the two

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20. *Restructuring Information*, LINN ENERGY, <http://www.linnenergy.com/restructuring> (last visited Feb. 14, 2017).

21. *See generally* Linn Energy Pooling Order, Okla. Corp. Comm'n, Cause CD No. 201506167-T/O (filed May 16, 2016), <http://imaging.occeweb.com/AP/Orders/occ5283094.pdf>.

22. Gaedeke's Motion to Vacate Order No. 652804 and to Reopen Cause, Okla. Corp. Comm'n, Cause CD No. 201506167-T/O (filed June 1, 2016), <http://imaging.occeweb.com/AP/CaseFiles/occ5285805.pdf>.

23. Oral Report of the Administrative Law Judge in Response to Motions to Vacate Orders and to Reopen Causes, Okla. Corp. Comm'n, Cause CD Nos. 201506166-T/O & 201506167-T/O (filed June 27, 2016), <http://imaging.occeweb.com/AP/CaseFiles/occ5291648.pdf>.

24. *Id.*

25. Oral Appeal of the Administrative Law Judge's Ruling in Response to Motions to Vacate Orders and to Reopen Causes, Okla. Corp. Comm'n, Cause CD Nos. 201506166-T/O & 201506167-T/O (filed July 22, 2016), <http://imaging.occeweb.com/AP/CaseFiles/occ5297809.pdf>.

26. Order Granting Motion to Reopen and Order Denying Motion to Vacate Orders 652804 and 653111, Okla. Corp. Comm'n, Cause CD Nos. 201506166-T/O & 201506167-T/O (filed Jan. 18, 2017), <http://imaging.occeweb.com/AP/Orders/occ5343991.pdf>.

tests used to determine whether a proceeding meets the police power exception in the context of three recent Fifth and Tenth Circuit cases. Part IV draws comparisons between groups of cases applying the police power exception and forced poolings. These cases come from not only the Tenth Circuit Court of Appeals, but also the Fifth Circuit because the vast majority of E&P bankruptcies have been filed in Texas.<sup>27</sup> An understanding of the Oklahoma Corporation Commission, the automatic stay, and the police power exception leads to the logical conclusion that a forced pooling should be excepted from the automatic stay.

### *I. The Oklahoma Corporation Commission*

The Oklahoma Corporation Commission was created by the Oklahoma Constitution.<sup>28</sup> By statute, the Corporation Commission is empowered to “establish an Oil and Gas Department under the jurisdiction and supervision of the Corporation Commission.”<sup>29</sup> The Oil and Gas Department has “exclusive jurisdiction, power, and authority”<sup>30</sup> over nearly every facet of oil and gas operations in Oklahoma, including “the conservation of oil and gas,”<sup>31</sup> and “the exploration, drilling, development, producing or processing for oil and gas on the lease site.”<sup>32</sup>

Everything the Oil and Gas Division does for the conservation of oil and gas it does in an effort to further public policies: eliminating waste, maximizing hydrocarbon recovery, protecting the correlative rights of all owners, and preventing pollution.<sup>33</sup> One way the Corporation Commission seeks to further its public policy goals is through forced poolings.<sup>34</sup> The forced pooling statute provides that when working interest owners within an established spacing unit have not, will not, or cannot come to an agreement about how, where, or whether to drill a well in the unit, the Corporation Commission may “require such owners to pool and develop their lands in the spacing unit as a unit.”<sup>35</sup> Before exploring how the police power exception interacts with a forced pooling, it is first necessary to understand forced poolings themselves. This section attempts to explain the events

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27. OIL PATCH BANKRUPTCY MONITOR, *supra* note 8, at 5.

28. OKLA. CONST. art. IX, § 15.

29. 17 OKLA. STAT. § 51 (2011).

30. *Id.* § 52.A.1.

31. *Id.* § 52.A.1.a.

32. *Id.* § 52.A.1.c.

33. OKLA. ADMIN. CODE § 165:10-1-1 (2016).

34. 52 OKLA. STAT. § 87.1(e) (2011).

35. *Id.*

leading up to a forced pooling, the policy behind forced poolings, and the procedure for obtaining a forced pooling.

*A. Forced Poolings: When?*

Before a working interest owner can apply for a pooling order, the tract of land to be developed must be within an established spacing unit.<sup>36</sup> In order to prevent the waste of oil and gas and to protect the correlative rights of mineral interest owners, the Corporation Commission has the power to establish “well spacing and drilling units . . . covering any common source of supply.”<sup>37</sup> A spacing order must be issued pursuant to title 52, section 87.1(a) of the Oklahoma Statutes to create the established spacing unit.<sup>38</sup> In order to create a spacing unit, a “person owning an interest in the minerals” or owning “the right to drill a well for oil or gas” within the common source of supply can petition the Corporation Commission to create a “unit.”<sup>39</sup> Before the spacing hearing, notice must be given by publication in a newspaper in Oklahoma County and by publication in a newspaper in any county in which the lands in the petition are situated.<sup>40</sup> The order establishing the spacing unit must include: (1) the outside boundaries of the unit; (2) the size, form, and shape of the unit; (3) the drilling pattern; and (4) the location of the permitted well.<sup>41</sup> After a spacing order is entered, only one well may be drilled on the unit<sup>42</sup> and must be drilled in the location specified by the Corporation Commission (generally, the center of the unit).<sup>43</sup>

Once a unit is created, any owner of an undivided working interest in the unit has the right to drill for, produce, and sell oil and gas drawn from the unit.<sup>44</sup> But the Corporation Commission requires that every working interest owner must agree to develop the land before drilling can commence.<sup>45</sup> Owners in the unit have the option to “validly pool their interest and develop their lands” together.<sup>46</sup> With a Joint Operating Agreement (JOA)<sup>47</sup>

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36. *Id.*

37. *Id.* § 87.1(a).

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* § 87.1(c).

42. *Id.*

43. OKLA. ADMIN. CODE § 165:10-1-24(a) (2016).

44. See Charles Nesbitt, *A Primer on Forced Pooling of Oil and Gas Interests in Oklahoma*, 50 OKLA. B.J. 648, 648 (1979).

45. *Id.*

46. 52 OKLA. STAT. § 87.1(e) (2011).

entered into by every working interest owner, the designated well operator can apply for a “Permit to Drill” with the Conservation Division of the Corporation Commission without needing to apply for a pooling order.<sup>48</sup> A pooling order becomes necessary, however, when, for any reason, the owners in a unit have not, will not, or cannot enter into a JOA.<sup>49</sup>

*B. Forced Poolings: Why?*

There are several reasons why a Pooling Order may be necessary. First, it is possible that the owners in a unit simply do not know who owns each working interest in the unit. This could mean the chain of title for one of the tracts within the unit stopped, or, perhaps, the other working interest owners cannot locate a final working interest owner. It could also be that one of the working interest owners, for one reason or another, does not want to drill a well in the unit. Finally, there could be a scenario in which every working interest owner has agreed to drill a well, but they cannot agree on a designated operator or how to drill the well (i.e., horizontally or vertically). In any event, without securing the consent of every working interest owner (all of whom are necessary to enter into a JOA), none of the working interest owners in the unit would be able to drill a well without a Pooling Order from the Corporation Commission.

The most apparent purpose of a forced pooling is to fulfill the Corporation Commission’s policy goals: preventing waste, maximizing recovery, and protecting correlative rights.<sup>50</sup> A forced pooling in a designated spacing unit prevents waste by ensuring only one well is drilled in a unit, thus limiting the number of wells drilled into each formation. Without the coordination of spacing and pooling, several working interest owners could, theoretically, drill multiple wells into the same formation. Such uncoordinated activity can result in repercussions contrary to the Corporation Commission’s policy goals, including decreased rates of

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47. A JOA is the contractual framework for a Joint Venture—when two or more working interest owners agree to undertake exploration and production of hydrocarbons. Muhammad Waqas, *History and Development of JOAs in the Oil and Gas Industry*, OIL & GAS FIN. J. (Oct. 9, 2014), <http://www.ogfj.com/articles/print/volume-11/issue-10/features/joint-operating-agreements.html>. A standard JOA will designate a well-operator, detail the scope of the agreement, and allocate the expenses and profits shared by each party. *Id.* Additionally, a JOA will contain standard contract provisions such as sections concerning duration, default, dispute resolution, and withdrawal. *Id.*

48. OKLA. ADMIN. CODE § 165:10-3-1(a)(1) (2016).

49. 52 OKLA. STAT. § 87.1(e).

50. OKLA. ADMIN. CODE § 165:10-1-1.



recovery, production in excess of pipeline transport capacity, and, possibly, pollution.<sup>51</sup>

Forced poolings maximize recovery by ensuring any willing working interest owner in an established spacing unit has the ability to drill a well over the protests of any “holdout” working interest owners.<sup>52</sup> Without the forced pooling mechanism, a single, non-consenting working interest owner could completely thwart any (and every) attempt to drill within a designated spacing unit. The Corporation Commission prefers not to limit the recovery of hydrocarbons based on a single party’s misgivings, and forced poolings prevent that very issue. Forced poolings create an easier avenue for a working interest owner to drill in a spacing unit without a JOA. More drilling inherently means more hydrocarbon recovery.

While a forced pooling clearly benefits working interest owners who want to drill, a forced pooling also seeks to protect the correlative rights of *all* working interest owners in a spacing unit, including those opposed to drilling within the unit. The non-consenting working interest owner is offered a choice: he can participate in the drilling efforts, sharing his proportionate costs and keeping his share of the profits; or he can receive a “bonus,” foregoing his right to participate in drilling the well.<sup>53</sup> By giving up his right to financial participation in the cost (and risk) of the intended well, the non-participating owner surrenders his working interest but retains his one-eighth royalty interest in the mineral estate.<sup>54</sup> The bonus given to a non-participating owner is usually cash, an excess royalty interest, or some combination thereof, although the excess royalty interest is most common.<sup>55</sup> The value of the bonus is supposed to equal the value of an oil and gas lease had the parties entered into the lease voluntarily.<sup>56</sup> A forced pooling accounts for every working interest owner, making sure each non-

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51. *Oklahoma Corporation Commission History*, OKLA. CORP. COMMISSION, <http://www.occeweb.com/Comm/commissionhist.htm> (last visited Dec. 17, 2017). In fact, this very issue led to the regulation of oil and gas by the Corporation Commission in the first place. *Id.*

52. There are, of course, necessary procedural steps a prospective well operator must take before he can pool his fellow working interest owners. One such step is a hearing where his fellow co-tenants can object to the forced pooling. These procedures are discussed *infra* Section I.C.

53. Nesbitt, *supra* note 44, at 649.

54. *Id.* Oklahoma statutorily defines a mineral estate as comprised of seven-eighths working interest and one-eighth royalty interest. 52 OKLA. STAT. § 87.1(e).

55. Nesbitt, *supra* note 44, at 650–51.

56. *Id.* at 650.

participating or non-consenting owner receives his fair share, and protects the correlative rights of the working interest owners.

*C. Forced Poolings: How?*

The Corporation Commission has extensive rules and procedures that a would-be well operator must follow to obtain a pooling order.<sup>57</sup> To begin a pooling proceeding, the Oklahoma Corporation Commission Rules of Practice require a detailed application to the Corporation Commission.<sup>58</sup> The application must identify each of the parties (the applicant and each working interest owner), set forth the facts (location of the unit, projected cost of the well, and others), provide the legal authority for the application (title 52, section 87.1 of the Oklahoma Statutes), and state the relief sought (a pooling order).<sup>59</sup> The applicant must also present a notice of hearing to be served with the application detailing the time, date, and place of the hearing, the nature of the hearing, the formations affected by the potential pooling, and the applicant's contact information.<sup>60</sup> Additionally, the notice must be published at least fifteen days before the hearing in a newspaper in Oklahoma County and "in each county in which the lands embraced in the application are located."<sup>61</sup>

Beyond the general application requirements, a pooling applicant is also required to include a statement showing that the applicant "exercised due diligence to locate each respondent," and that the working interest owners already attempted to reach an agreement through a JOA.<sup>62</sup> Furthermore, the notice of hearing and application must be served on each working interest owner within the drilling and spacing unit no less than fifteen days prior to the hearing (although service can be by "restricted mail").<sup>63</sup> Hearings are typically held in the courtrooms in the Corporation Commission's principal office in Oklahoma City.<sup>64</sup> A vast majority of the conservation applications (including pooling applications) are uncontested, but a hearing takes place nonetheless, albeit quickly.<sup>65</sup> Any contested case is heard by an

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57. The Oklahoma Corporation Commission Rules of Practice are codified at OKLA. ADMIN. CODE §§ 165:5-1-1 to 5-27-14 (2016).

58. *Id.* § 165:5-7-1.

59. *Id.* § 165:5-7-1(d).

60. *Id.* § 165:5-7-1(j), (l).

61. *Id.* § 165:5-7-1(n)(2).

62. *Id.* § 165:5-7-7(a).

63. *Id.* § 165:5-7-7(b).

64. *Id.* § 165:5-13-1(a).

65. Nesbitt, *supra* note 44, at 656. Hearings are governed by OKLA. ADMIN. CODE § 165:5-13-3.

Administrative Law Judge who prepares a written report to send to each party.<sup>66</sup> After ten days, the Corporation Commission enters the pooling order.<sup>67</sup>

Given the growing frequency with which oil companies in the region are declaring bankruptcy, it is necessary to understand the procedures an E&P company must follow to drill a well in Oklahoma. A forced pooling affects the rights owned in a mineral estate and even the value of the mineral estate itself. As a judicial proceeding affecting a valuable property right that would enter the bankruptcy estate upon the filing of a bankruptcy petition,<sup>68</sup> forced poolings provide a lens through which to analyze both the automatic stay and the police power exception.

## II. The Automatic Stay

“The automatic stay bars anyone from taking action to recover a debt then owing by the debtor or acting to affect property of the debtor or the estate or in the possession of the estate.”<sup>69</sup> The stay serves to protect both creditors and debtors.<sup>70</sup> For creditors, the automatic stay ensures that the goal of bankruptcy—equal treatment among creditors—is achieved by preventing a “chaotic and uncontrolled scramble for the debtor’s assets in a variety of uncoordinated proceedings in different courts.”<sup>71</sup> The automatic stay, coupled with the jurisdiction granted to the bankruptcy court by 28 U.S.C. § 157(a),<sup>72</sup> “assures creditors that the debtor’s other creditors are not racing to various courthouses to pursue independent remedies to drain the

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66. OKLA. ADMIN. CODE § 165:5-13-4(a)-(b).

67. *Id.* § 165:5-13-4(c).

68. 11 U.S.C. § 541(a)(1) (2012).

69. 1 COLLIER ON BANKRUPTCY ¶ 1.05[1] (16th ed. 2013).

70. *Dean v. Trans World Airlines, Inc.*, 72 F.3d 754, 755 (9th Cir. 1995).

71. *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5th Cir. 1986) (quoting *In re Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982)).

72. The grant of jurisdiction to bankruptcy judges by a district court is technically at the discretion of the district court. 28 U.S.C. § 1334(a) (2012) (granting “original and exclusive jurisdiction of all cases under [the Bankruptcy Code]”); *id.* § 157(a) (a “district court *may* [refer] any or all cases under title 11 and any or all proceedings arising under [the Bankruptcy Code] . . . to the bankruptcy judges for the district.” (emphasis added)). However, most jurisdictions, including every district in Oklahoma, have a standing order referring cases under the Bankruptcy Code (Title 11) to the district’s bankruptcy judges. *See, e.g.*, E.D. OKLA. CIV. R. 84.1(a)(1); N.D. OKLA. CIV. R. 84.1(a)(1); W.D. OKLA. CIV. R. 81.4(a)(1). The district court has appellate jurisdiction over cases arising under Title 11. 28 U.S.C. § 158(a) (2012).

debtor's assets."<sup>73</sup> Equally as important, the automatic stay provides a debtor immediate and self-executing relief against his creditors.<sup>74</sup> The automatic stay gives the debtor "room to breathe" so he can attempt repayment or reorganization without fear of collection efforts or harassment by his creditors.<sup>75</sup>

When an entity files a petition for bankruptcy under 11 U.S.C. § 301 (voluntary petition), § 302 (joint petition), or § 303 (involuntary petition), a "bankruptcy estate" is created.<sup>76</sup> The estate consists, in part, of the legal or equitable interests of the debtor in property before the commencement of the bankruptcy.<sup>77</sup> The automatic stay generally exists to protect the bankruptcy estate for the good of both the debtor and its creditors.<sup>78</sup> Most notably, the automatic stay prevents the commencement or continuation of a judicial action against the debtor that could have been brought prior to the commencement of the bankruptcy,<sup>79</sup> the enforcement of a judgment rendered prior to the commencement of the bankruptcy,<sup>80</sup> and "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."<sup>81</sup> Accordingly, the automatic stay represents an incredibly powerful tool with important implications for parties in interest in a bankruptcy.

To enforce the automatic stay, a court "may issue any order, process, or judgment that is necessary or appropriate."<sup>82</sup> Furthermore, a court may—when the debtor suffers an injury by a willful violation of the stay—order recovery of actual damages, including costs and attorneys' fees, and (in appropriate circumstances) punitive damages.<sup>83</sup> As soon as a creditor becomes aware of the debtor's bankruptcy (and the resulting automatic stay), "any intentional act that results in a violation of the stay is 'willful,'"

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73. *Dean*, 72 F.3d at 755–56.

74. *Id.* at 755.

75. *Id.*

76. 11 U.S.C. § 541(a) (2012).

77. *Id.* § 541(a)(1). While the statute lists five other interests that form the bankruptcy estate, none are relevant here. Additionally, none of the exceptions listed in subsection (b) are relevant.

78. *See id.* §§ 362(a)(1)–(6). Each provision specifically concerns the bankruptcy estate.

79. *Id.* § 362(a)(1).

80. *Id.* § 362(a)(2).

81. *Id.* § 362(a)(3). The automatic stay also contemplates several other potential actions by creditors, but subsections (a)(1)–(3) are the most pertinent to the present issue.

82. *Id.* § 105(a).

83. *Id.* § 362(k)(1).

and “[n]o specific intent to violate the stay or malice is required.”<sup>84</sup> Furthermore, a debtor in bankruptcy has no obligation to notify his creditors of the existence of the stay.<sup>85</sup>

To avoid a willful or negligent violation of the stay, a creditor should be aware of the duration of the automatic stay, governed by 11 U.S.C. § 362(c). This section, in part, provides that “a stay of an act against property of the estate expires when the property is no longer property of the estate.”<sup>86</sup> The stay can also end when (1) the bankruptcy is closed, (2) the bankruptcy is dismissed, or (3) the debtor receives or is denied a discharge.<sup>87</sup> The stay may also be modified, suspended, or terminated by the court on request of a creditor or a “party in interest.”<sup>88</sup>

The automatic stay is a complex and intricate legal infrastructure. Its several interworking parts create a massive web of protections for debtors, creditors, and the property of the estate itself. As evidenced by the strict rules and sanctions accompanying a violation of the stay,<sup>89</sup> this two-way shield should not be trifled with lightly. Therefore, it is extremely important that any party or creditor interacting with a debtor in bankruptcy understand the automatic stay, its exceptions, and its reach.

### III. The Tests

As discussed in Part I, forced poolings are judicial proceedings that seek to control property that may fall within the bankruptcy estate. Furthermore, as discussed in Part II, the continuation or commencement of any such judicial proceeding should be automatically stayed under 11 U.S.C. § 362(a). Therefore, absent some exception, a forced pooling would violate the protections afforded to a debtor by the automatic stay.

The “commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit’s police and regulatory power” is excepted from the automatic stay.<sup>90</sup> This exception is

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84. COLLIER ON BANKRUPTCY, *supra* note 69, ¶ 362.12[3].

85. *Id.* ¶ 362.12.

86. *Id.* ¶ 362.06.

87. 11 U.S.C. § 362(c)(2)(A)–(C).

88. *Id.* § 362(d).

89. *See id.* § 362(k)(1).

90. *Id.* § 362(b)(4). This exception also includes organizations “exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction.” *Id.* This clause is not pertinent to this analysis as it relates to the Corporation Commission. Additionally, the enforcement of the governmental unit’s power includes “the enforcement of a judgment other than a money

termed the “police power exception.”<sup>91</sup> The purpose of the police power exception is detailed in its legislative history:

Paragraph (4) excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay.<sup>92</sup>

The safety offered by the bankruptcy court is not meant to be “a haven for wrongdoers.”<sup>93</sup> Thus, this section arises out of the need to continue regulatory, police, and criminal actions despite the automatic stay.<sup>94</sup> The exception even goes so far as to allow the enforcement of judgments or orders, other than money judgments.<sup>95</sup>

While the exception “is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety,”<sup>96</sup> the exception is not “limited to those situations where ‘imminent and identifiable harm’ to the public health and safety or ‘urgent public necessity’ is shown.”<sup>97</sup> So, although the exception itself is “limited,” its application indicates the exception is “construed broadly so as not to override state laws enacted to protect some public interest.”<sup>98</sup>

To determine whether a proceeding falls within the police power exception, “courts have applied two ‘related and somewhat overlapping’ tests: the pecuniary purpose test and the public policy test.”<sup>99</sup> “In order for

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judgment.” *Id.* Because forced poolings are not “money judgments,” this clause is also irrelevant to the present discussion. The Corporation Commission falls under the statutory definition of a “governmental unit.” *Id.* § 101(27).

91. *In re Halo Wireless, Inc.*, 684 F.3d 581, 588 (5th Cir. 2012); *In re Yellow Cab Coop. Ass’n*, 132 F.3d 591, 598 (10th Cir. 1997).

92. *In re Commonwealth Oil Ref. Co.*, 805 F.2d 1175, 1182–83 (5th Cir. 1986) (quoting S. REP. NO. 95-989, at 52 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5838).

93. COLLIER ON BANKRUPTCY, *supra* note 69, ¶ 362.05[5][a].

94. *Id.*

95. 11 U.S.C. § 362(b)(4).

96. *Commonwealth Oil Ref. Co.*, 805 F.2d at 1184 n.7 (quoting 124 CONG. REC. H11089 (1978)).

97. *Id.* at 1184.

98. *Id.*

99. *In re Halo Wireless, Inc.*, 684 F.3d 581, 588 (5th Cir. 2012); see also *In re Yellow Cab Coop. Ass’n*, 132 F.3d 591, 597 (10th Cir. 1997); *Eddleman v. U.S. Dep’t of Labor*, 923

the police powers exception to apply, an action by the state must satisfy one of these tests.”<sup>100</sup>

The pecuniary purpose test asks whether the proceeding in question seeks primarily to further or protect the government’s pecuniary interest in the property of the estate as opposed to promoting public policy.<sup>101</sup> If the purpose of the proceeding is to protect a pecuniary interest, then the exception does not apply and the proceeding would be automatically stayed.<sup>102</sup> If, however, the proceeding promotes public policy and welfare, then the exception would apply and the proceeding would not be stayed, regardless of any purported or real governmental pecuniary interest in any property in the estate.<sup>103</sup>

In addition to the pecuniary purpose test, the Circuits have also applied the public policy test, asking whether the governmental unit is “effectuating public policy” as opposed to adjudicating private rights.<sup>104</sup> If the proceeding primarily serves to promote public policy, then the exception applies.<sup>105</sup> If, however, the proceeding primarily seeks to adjudicate or advance the private rights of individuals, then the exception does not apply and the proceeding in question would be stayed.<sup>106</sup> Understanding the two tests requires exploration of three recent cases applying the police power exception in the Tenth and Fifth Circuits: *In re Halo Wireless, Inc.*,<sup>107</sup> *Eddleman v. United States Department of Labor*,<sup>108</sup> and *In re Yellow Cab Cooperative Ass’n*.<sup>109</sup>

#### A. *In re Halo Wireless, Inc.*

The most recent application of the police power exception by the Fifth Circuit occurred in the 2012 case *In re Halo Wireless, Inc.*<sup>110</sup> In *Halo Wireless*, various local telephone companies brought actions against a debtor corporation before several states’ Public Utility Commissions

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F.2d 782, 791 (10th Cir. 1991), *overruling recognized by* *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013).

100. *In re Pollock*, 402 B.R. 534, 536 (Bankr. N.D.N.Y. 2009).

101. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

102. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

103. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

104. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

105. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

106. *Halo Wireless*, 684 F.3d at 588; *Eddleman*, 923 F.2d at 791.

107. 684 F.3d 581 (5th Cir. 2012).

108. 923 F.2d 782 (10th Cir. 1991).

109. 132 F.3d 591 (10th Cir. 1997).

110. 684 F.3d 581.

(PUCs) to recover fees owed to them under applicable state and agency laws governing telecommunications.<sup>111</sup> The debtor, Halo Wireless, Inc., was a small telecommunications company claiming to provide wireless phone and data services<sup>112</sup> pursuant to its license from the Federal Communications Commission.<sup>113</sup> The dispute before the PUCs focused on the “type of service Halo actually provide[d], and whether or not Halo . . . properly compensate[ed] local companies for the call traffic [Halo] transfer[red] to them.”<sup>114</sup> Because of the number of suits filed against it before the PUCs, Halo filed for bankruptcy.<sup>115</sup> The various telecommunications companies filed motions requesting an exemption from the automatic stay under § 362(b)(4).<sup>116</sup> The bankruptcy court ruled the PUC proceedings were excepted; Halo appealed directly to the Fifth Circuit.<sup>117</sup>

Before applying the tests, the court contemplated the meaning of “continued by” in the police power exception.<sup>118</sup> Halo argued the PUC proceedings should not be excepted because the actions were each brought by individual, private companies and not the government itself.<sup>119</sup> Halo interpreted the police power exception to require an action be “prosecuted by and in the name of a governmental unit.”<sup>120</sup> However, the court found the statutory language not only excepts the “commencement,” but also the “*continuation* of an action or proceeding by a governmental unit.”<sup>121</sup> This, the court reasoned, indicated the statute also excepts actions before a governmental unit, “without regard to who initially filed the complaint.”<sup>122</sup>

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111. *Id.* at 585.

112. Halo claimed to provide wireless Commercial Mobile Radio Service defined by § 332(d)(1) of the Federal Telecommunications Act. *Id.* at 584.

113. *Id.* at 584-85.

114. *Id.* at 585.

115. *Id.*

116. *Id.*

117. *Id.* Although the district court would typically have appellate jurisdiction over the action before the bankruptcy court per 28 U.S.C. § 158(a), the bankruptcy court certified the appeal directly to the Fifth Circuit. *Id.* at 585-86. This decision is permitted by § 158(d)(2)(A)(i): “[T]he judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance.” 28 U.S.C. § 158(d)(2)(A)(i) (2012).

118. *Halo Wireless*, 684 F.3d at 588-89.

119. *Id.* at 588.

120. *Id.*

121. *Id.* at 589 (quoting 11 U.S.C. § 362(b)(4) (2012)).

122. *Id.* at 592.



The Fifth Circuit held the PUC proceedings passed the pecuniary interest test because the proceedings did not protect a government pecuniary interest in Halo's bankruptcy estate.<sup>123</sup> The court equated a government protecting its pecuniary interest to the government seeking access to property within the bankruptcy estate.<sup>124</sup> Because the police power exception bars the entry of money judgments against a debtor, the court reasoned, the PUCs could not enforce any money judgment against Halo without going through the bankruptcy court.<sup>125</sup> The PUCs, therefore, could not gain access to Halo's property.<sup>126</sup> As such, the court held the PUC proceedings passed the pecuniary purpose test under the police power exception and were not subject to the automatic stay.<sup>127</sup>

The court also held the PUC proceedings were aimed at effectuating public policy and, therefore, satisfied the public policy test.<sup>128</sup> The court reasoned there was an obvious public policy component to the state and federal regulation of telecommunications.<sup>129</sup> The Federal Telecommunications Act (FTA) was passed, in part, to prevent discrimination in the availability of telecommunications.<sup>130</sup> The FTA, the court found, "contemplate[d] a public purpose to state regulation of telecommunications," and indicated that the "regulation of telecommunications carriers serves the public interest."<sup>131</sup> Furthermore, the court determined the statutory and common law surrounding PUCs "demonstrate[d] their public purpose."<sup>132</sup> Finally, although a proceeding adjudicating private rights fails the public policy test, the court remained unconcerned that the proceedings were initiated by private companies over private contracts.<sup>133</sup> Thus, the public policy nature of the PUC proceedings was strong enough to except those proceedings from the automatic stay.<sup>134</sup>

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123. *Id.* at 593.

124. *Id.*

125. *Id.* at 594.

126. *Id.* at 593.

127. *Id.* at 595.

128. *Id.*

129. *Id.* at 594.

130. 47 U.S.C. § 151 (2012).

131. *Halo Wireless*, 684 F.3d at 594.

132. *Id.* (citing *May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 107 S.W.2d 41 (Mo. 1937); *Campaign for a Prosperous Ga. v. Ga. Power Co.*, 174 329 S.E.2d 570 (Ga. Ct. App.1985); TEX. UTIL. CODE ANN. § 52.001(a) (1997)).

133. *See id.* at 592.

134. *See id.* at 595.

### B. Eddleman v. United States Department of Labor

In 1991, the Tenth Circuit addressed the police power exception in *Eddleman v. United States Department of Labor*.<sup>135</sup> The Eddlemans, owners of a mail-hauling business working under contract for the United States Postal Service, filed a § 301 petition for Chapter 11 bankruptcy.<sup>136</sup> The U.S. Department of Labor (DOL) filed an action against the Eddlemans, claiming violations of the Service Contract Act (SCA).<sup>137</sup> The DOL alleged the Eddlemans, prior to petitioning for bankruptcy, failed to pay workers adequate wages and keep proper records of hours worked and wages paid.<sup>138</sup> Pursuant to the SCA, the DOL filed an administrative enforcement action for back wages and inclusion of the Eddlemans on the SCA violator list.<sup>139</sup> Believing the DOL had violated the automatic stay, the Eddlemans filed an adversary proceeding in the bankruptcy court seeking enforcement of the stay against the DOL action.<sup>140</sup> The Eddlemans also sought damages for the alleged willful violation of the automatic stay.<sup>141</sup> The DOL moved to dismiss the adversary proceeding, claiming it was acting within its police and regulatory powers in accordance with § 362(b)(4).<sup>142</sup> The bankruptcy court denied the motion, and the district court affirmed the decision.<sup>143</sup> The DOL appealed to the Tenth Circuit.<sup>144</sup>

The Tenth Circuit concluded the enforcement proceedings passed the pecuniary purpose test because the “remedies sought by the DOL [were] not designed to advance the government’s pecuniary interest.”<sup>145</sup> Seeking

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135. 923 F.2d 782 (10th Cir. 1991), *overruling recognized by* *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013). *Rajala*’s discussion of *Eddleman* was limited to the appellate jurisdiction of the court and did not discuss the *Eddleman* court’s application of the pecuniary purpose and public policy tests. *Rajala*, 709 F.3d at 1034–35.

136. *Eddleman*, 923 F.2d at 783.

137. *Id.* The Service Contract Act, codified at 41 U.S.C. §§ 6701–6707, requires federal contractors to pay statutory minimum wages and fringe benefits and maintain certain working conditions. 41 U.S.C. § 6703 (2012). A violation of the SCA renders the responsible party liable for back pay to the employees, the cancellation of the government contract, inclusion on a list of SCA violators, and a three-year prohibition from contracting with the government. *Id.* §§ 6705–6706.

138. *Eddleman*, 923 F.2d at 783.

139. *Id.*; 41 U.S.C. §§ 6705–6707.

140. *Eddleman*, 923 F.2d at 783.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.* at 791.

liquidation of back-pay claims, the court reasoned, would not give the DOL access to the Eddlemans' bankruptcy estate.<sup>146</sup> Rather, the primary purpose of the DOL's ability to pursue the statutory damages was to "prevent unfair competition in the market by companies who pay substandard wages."<sup>147</sup> The police power exception, therefore, applied and the action was excepted from the automatic stay.<sup>148</sup>

The court also determined the remedies sought neither advanced nor adjudicated private rights and thus, passed the public policy test.<sup>149</sup> The court reasoned that, even though the DOL sought liquidation of back-pay claims for *individuals*, the DOL, in bringing the suit, was not advancing private rights.<sup>150</sup> The court's opinion was strengthened by the knowledge that any of the back-pay claimants would not be able to enforce their money judgment absent the normal bankruptcy procedures.<sup>151</sup> In fact, the claims for the individuals, the court held, were an acceptable way to enforce the policies of the SCA.<sup>152</sup> These public policies far outweighed any adjudication of private rights, thereby satisfying the public policy test as well.<sup>153</sup>

### C. *In re Yellow Cab Cooperative Ass'n*

In a later decision, the Tenth Circuit again applied the police power exception in *In re Yellow Cab Cooperative Ass'n*.<sup>154</sup> Yellow Cab, a certified taxi company in Colorado, filed a § 301 petition for a Chapter 11 bankruptcy.<sup>155</sup> The bankruptcy court authorized Yellow Cab, in an effort to pay Yellow Cab's creditors, to sell its assets to Taxi Associates, Inc.<sup>156</sup> One of Yellow Cab's assets was its Certificate of Public Convenience and Necessity (CPCN) authorizing Yellow Cab to operate up to 600 taxis in Denver.<sup>157</sup> Yellow Cab, however, had only operated 300 cabs for several years.<sup>158</sup> Because the sale to Taxi Associates, Inc. involved a CPCN (issued

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146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. 132 F.3d 591 (10th Cir. 1997).

155. *Id.* at 593.

156. *Id.*

157. *Id.*

158. *Id.*

by the Colorado PUC), the bankruptcy court required Yellow Cab to request the PUC's approval of the transfer.<sup>159</sup> In its "Transfer Decision," the PUC denied the application for transfer of the full certificate because "the unused authority under the CPCN had become dormant" and non-transferable, citing concerns over competition and public interest.<sup>160</sup> Yellow Cab initiated an adversary proceeding against the PUC to enjoin the PUC from blocking the transfer of the full 600-cab authority under the CPCN.<sup>161</sup> The bankruptcy court issued the injunction, holding the decision to limit the CPCN impermissibly controlled the property of the bankruptcy estate in violation of 11 U.S.C. § 362(a)(3).<sup>162</sup> The PUC appealed and the district court overturned the injunction, citing the police power exception.<sup>163</sup> Yellow Cab appealed to the Tenth Circuit.<sup>164</sup>

The Tenth Circuit held, following a very brief analysis, that the Transfer Decision passed the pecuniary purpose test.<sup>165</sup> The court went no further than to say the Transfer Decision effectuated public policy and was, therefore, excepted from the stay.<sup>166</sup> The court did not discuss the PUC's *lack* of pecuniary interest in denying the full transfer at all, focusing instead on the public policy reasons behind the PUC's Transfer Decision.<sup>167</sup> According to the PUC's Transfer Decision, "destructive competition" would arise out of the unconditional reactivation of the dormant portion of the CPCN and "approval of the transfer . . . would likely damage other carriers and the public interest."<sup>168</sup> The court held the PUC's action

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159. *Id.*

160. *Id.*

161. *Id.* at 593-94.

162. *Id.* at 594 (citing *Colorado Pub. Utils. Comm'n v. Yellow Cab Coop. Ass'n*, 194 B.R. 504, 506 (D. Colo. 1996)).

163. *Id.*

164. *Id.* A key issue in the case was whether or not the police power exception applied to actions violating 11 U.S.C. § 362(a)(3) (acts to obtain possession or exercise control over the property of the estate). *Id.* at 598. This is because the police power exception, as codified in 1997, was separated into subsections (b)(4) and (b)(5) and did not explicitly list subsection (a)(3) among the actions possibly excepted. *See id.* at 596 (dictating the actual language of the police power exception as it existed in 1997). The court found that, although subsection (a)(3) was not explicitly listed, the police power exception applied to actions stayed under subsection (a)(3). *Id.* at 598. Because the language of subsection (b)(4) now includes subsections (a)(1)–(3), (6), this issue is irrelevant to the analysis and application with regard to Corporation Commission forced poolings.

165. *Id.* at 597.

166. *Id.*

167. *Id.*

168. *Id.*

effectuated public policy and excepted that action from the automatic stay.<sup>169</sup>

The court also quickly dispensed with the public policy test, holding the Transfer Decision easily passed.<sup>170</sup> The court used the same analysis for the pecuniary purpose test in determining that the Transfer Decision passed the public policy test as well.<sup>171</sup> Notably, the court appeared unconcerned that the PUC action decreased the operating certificate from 600 to 300, affecting the private rights of both the debtor-seller and the purchaser.<sup>172</sup> It could be argued that the PUC proceeding adjudicated the private rights of both Yellow Cab and Taxi Associates, Inc. But, from its brief analysis, it appears the court was more concerned with the public interest factors behind the Transfer Decision discussed above.<sup>173</sup> As such, the court concluded the Transfer Decision did not primarily serve to adjudicate private rights and was excepted from the automatic stay.<sup>174</sup>

#### *D. Application to Corporation Commission Forced Poolings*

Based on the three aforementioned cases, pooling proceedings before the Corporation Commission involving a party in bankruptcy likely pass the pecuniary purpose test and will be excepted from the automatic stay. This is because neither the state nor the federal government typically has a pecuniary interest in the property rights<sup>175</sup> involved in the forced pooling. Much like the PUC proceedings in *Halo Wireless*, the DOL suit in *Eddleman*, and the PUC proceeding in *Yellow Cab Cooperative Ass'n*, forced poolings neither give the Corporation Commission access to the estate's property nor further the government's pecuniary interest. The pecuniary purpose test is thus easily dispensed with as it relates to forced poolings.

And, based on the three cases discussed above, forced poolings likely pass the public policy test and will be excepted from the stay. A court would likely find that the public policy underlying a forced pooling outweighs any private rights adjudicated in the process. The goal of a forced pooling (and any conservation proceeding) after all, is to prevent

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169. *Id.*

170. *Id.*

171. *Id.*

172. *See id.*

173. *See id.*

174. *Id.*

175. Those property rights being the various rights in privately owned mineral estates, that is, a working interest or a royalty interest.

waste, protect correlative rights, prevent pollution, and maximize hydrocarbon recovery.<sup>176</sup> The purpose of the proceeding is to promote public policy and protect public welfare. This remains true regardless of whether or not a working interest owner is involved in a pending bankruptcy.

*Halo Wireless* provides particularly useful insight in assessing how a court would rule on this issue because it involved third parties bringing administrative actions against a bankrupt party before a state agency. This parallels a working interest owner attempting to pool another working interest owner in the same unit despite the latter's bankrupt status. A strong argument can be made that a meaningful difference exists between local telephone companies seeking relief from the state PUC for a debtor's violation of agency law and an individual or corporation attempting to drill an oil well. A court could decide that the conservation proceedings merely adjudicate private rights under the guise of protecting public policy. It seems more likely, though, that the furtherance of public policy through the Corporation Commission will be seen as more important than the adjudication of private rights.

A parallel can also be drawn between the limitation of the CPCN in *Yellow Cab Cooperative Ass'n* and the modification of rights in a bankrupt party's mineral estate. The Tenth Circuit was not concerned with the limitation on the CPCN because of the public policy behind the limitation. This was the case even though the limitation blatantly affected the value of the bankruptcy estate in a concrete, measurable way. In contrast, a pooling does not (at least in theory) actually affect the value of the mineral estate.<sup>177</sup> Unlike the limitation on the CPCN, however, a working interest owner subject to a pooling order does not relinquish his rights for nothing in return; it is a bargained-for exchange. Therefore, any "effect" on the bankruptcy estate is not so much a diminution of its value but rather a metamorphosis of the rights owned in a mineral estate. Because the Tenth Circuit was not bothered by the diminution of the value of the bankruptcy estate through the CPCN limitation, it is difficult to imagine that the court would be troubled by a swap of working interest rights for a royalty interest.

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176. 17 OKLA. STAT. § 57 (2011).

177. A working interest is arguably more "valuable" than a royalty interest because the owner of the latter is more restricted in his rights. A working interest owner has full right, as an equal co-tenant, to explore and extract hydrocarbons whereas a royalty interest owner is limited to his share of any hydrocarbon sales.

The DOL suit in *Eddleman* bears little resemblance to a forced pooling, but an important lesson remains: the DOL filing the lawsuit on behalf of individuals did not run afoul of the public policy test. While the DOL sought liquidated claims for wages owed (asking the court to adjudicate private rights), the public policy allowing the DOL to do so far outweighed the private rights adjudicated. Similarly, the Corporation Commission would be asked, in a forced pooling, to adjudicate the private rights of the applicant, the working interest owner in bankruptcy, and every other working interest owner in the unit. The question then becomes whether the private rights of the individuals involved in a pooling outweigh the public policy underlying forced poolings.

#### *IV. The Police Power Exception in the Tenth and Fifth Circuits*

Because the three exemplary cases do not provide a sufficiently broad spectrum to determine the importance of private rights versus public policy, it becomes necessary to explore other Tenth and Fifth Circuit cases applying the police power exception. One particularly helpful line of cases deals with similar administrative proceedings conducted within the government agency itself. A comparison of these cases to forced pooling proceedings before the Corporation Commission provides additional examples of administrative agencies exercising their police powers while seemingly adjudicating private rights. Another informative set of cases deals with parties and attorneys (individuals) seeking Rule 11 sanctions against debtors. These actions, on their face, appear to be the adjudication of private rights and help to further clarify when public policy is adjudged to outweigh the private rights adjudicated.

##### *A. Administrative Proceedings*

Several administrative agencies act in a quasi-judicial capacity when they hear disputes between private parties that arise under the agencies' regulatory schemes.<sup>178</sup> Some administrative proceedings begin just like an ordinary lawsuit: an aggrieved party files a complaint with the administrative agency against another party, asking the agency to take some action against the latter.<sup>179</sup> While these administrative proceedings seem to

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178. See, e.g., *In re Aerobox Composite Structures, LLC*, No. 11-07-10138 MA, 2008 WL 1733601 (Bankr. D.N.M. Apr. 10, 2008); *In re Dan Hixson Chevrolet Co.*, 12 B.R. 917 (Bankr. N.D. Tex. 1981).

179. *Aerobox Composite Structures, LLC*, 2008 WL 1733601 at \*1; *Dan Hixson Chevrolet Co.*, 12 B.R. at 919.

adjudicate private rights, there are instances where the public policy component of the proceeding outweighs any private rights involved.<sup>180</sup> In those cases, the proceedings would be excepted from the automatic stay if the defending party enters bankruptcy.<sup>181</sup> But if the agency is serving solely in a quasi-judicial capacity to adjudicate private rights without reference to public policy, those proceedings are not excepted and should be stayed.<sup>182</sup>

In *In re Aerobox Composite Structures, LLC*, the Bankruptcy Court for the District of New Mexico considered whether a proceeding against a debtor in bankruptcy before the state Human Rights Commission (HRC) violated the automatic stay.<sup>183</sup> One of the debtor's former employees, Hollinger, filed a complaint with the HRC alleging a violation of the state's Human Rights Act.<sup>184</sup> After settlement negotiations failed, the HRC held a proceeding against the debtor, finding in favor of Hollinger and awarding her compensatory damages.<sup>185</sup> The debtor believed the proceeding before the HRC violated the automatic stay.<sup>186</sup> Furthermore, the debtor argued the proceeding was not excepted by § 362(b)(4) because the proceeding was initiated by a private party and resulted in monetary damages, therefore advancing Hollinger's private rights.<sup>187</sup> The court disagreed, even though Hollinger was "the direct beneficiary" of the proceeding, because the public policy of preventing and deterring discriminatory practices in the workplace outweighed the private rights adjudicated.<sup>188</sup> The court concluded, therefore, that the proceeding clearly passed the public policy test and was excepted from the automatic stay.<sup>189</sup>

In *In re Dan Hixson Chevrolet Co.*, Volkswagen of America, Inc. sought to terminate its franchise agreement with a franchisee when the franchisee entered Chapter 11 bankruptcy.<sup>190</sup> To terminate the agreement, Volkswagen first notified the Texas Motor Vehicle Commission ("Commission").<sup>191</sup> Volkswagen sought relief from the automatic stay so the Commission could

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180. *Aerobox Composite Structures, LLC*, 2008 WL 1733601 at \*3; *Dan Hixson Chevrolet Co.*, 12 B.R. at 922.

181. *Aerobox Composite Structures, LLC*, 2008 WL 1733601 at \*3.

182. *Dan Hixson Chevrolet Co.*, 12 B.R. at 922.

183. *Aerobox Composite Structures, LLC*, 2008 WL 1733601 at \*1.

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.* at \*2.

188. *Id.* at \*3.

189. *Id.*

190. 12 B.R. 917, 918 (Bankr. N.D. Tex. 1981).

191. *Id.*



rule on whether the franchise agreement should be terminated, arguing that the Commission proceeding fell under the police power exception.<sup>192</sup> The bankruptcy judge first examined the nature of the Commission, finding that the Texas Motor Vehicle Code and the creation of the Commission itself were both proper exercises of the state's police and regulatory powers.<sup>193</sup> The court next considered whether "every action or proceeding taken by or before the [Commission] is 'to enforce its police or regulatory power,' within the meaning of § 362(b)(4) of the Bankruptcy Code."<sup>194</sup> The court rejected this view, finding the mere creation of an agency or governmental entity through the state's proper exercise of its police powers does not inherently mean the agency is always exempted from the automatic stay.<sup>195</sup> In fact, the court reasoned that a different construction would render the automatic stay meaningless.<sup>196</sup>

The court determined that whether an agency proceeding will be excepted depends on the nature of that agency's power.<sup>197</sup> If the agency acts in an executive capacity—exercising its police powers—then that action will be excepted.<sup>198</sup> If, however, the agency acts in a quasi-judicial capacity—adjudicating private rights and not effectuating public policy—that action will not be excepted from the automatic stay.<sup>199</sup> The court concluded that because the hearing affected only the parties involved and not the public as a whole, the Commission was acting in a quasi-judicial capacity by adjudicating the private rights of Volkswagen and the franchisee.<sup>200</sup> Therefore, the court declined to exempt the Commission proceeding from the stay.<sup>201</sup>

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192. *Id.* at 918–19.

193. *Id.* at 919.

194. *Id.* at 920 (emphasis added). The court quoted the relevant section of the Texas Motor Vehicle Code in finding the public policy behind the Commission. *Id.* at 919. Notably, the quoted statute explained that the sale of new motor vehicles "vitally affects the general economy of the State and the public interest and welfare of its citizens," and that the "purpose of this Act [is] to exercise the State's police power." *Id.* (citation to the Texas Motor Vehicle Code omitted).

195. *Id.* at 920.

196. *Id.*

197. *Id.* at 921.

198. *Id.*

199. *Id.*

200. *Id.* at 922.

201. *Id.*

*B. Rule 11 Sanctions*

A proceeding for Rule 11 sanctions appears to adjudicate the private rights of two different parties. Federal Rule of Civil Procedure 11 lists some of an attorney's duties and responsibilities to the court and to his client.<sup>202</sup> In addition to these responsibilities, Rule 11 provides that a court, either on its own volition or on motion from an opposing party, may issue sanctions for violating the responsibilities imposed by the rule.<sup>203</sup> When an opposing party files a motion for Rule 11 sanctions, that dispute is seemingly between two private parties. However, as the Northern District of Oklahoma held in *Maritan v. Todd*,<sup>204</sup> the public policy behind an adjudication for Rule 11 sanctions outweighs any private rights adjudicated.<sup>205</sup>

In *Maritan*, a magistrate judge for the Northern District of Oklahoma considered whether an appeal arising out of Rule 11 sanctions was automatically stayed when the lawyer subject to the sanctions was a debtor in bankruptcy.<sup>206</sup> The party seeking the sanctions (appellant) argued that proceedings for Rule 11 sanctions fall under the police power exception because of the regulatory purpose of the proceedings.<sup>207</sup> Citing a Seventh Circuit opinion, the court reasoned that Rule 11 sanctions incorporate a strong public policy component extending beyond mere fee shifting.<sup>208</sup> Rule 11, the court explained, imposes sanctions on lawyers as punishment for unprofessional conduct during the course of litigation, not necessarily to reduce the costs of the prevailing party.<sup>209</sup> The court found that parties seeking Rule 11 sanctions are "private attorney[s] general," acting as agents of the federal judiciary to punish unprofessional behavior in litigation.<sup>210</sup> This, the court decided, was true despite the fact that sanctions could be wholly pecuniary.<sup>211</sup> Even though proceedings for sanctions deal with private rights, the purpose "is not an attempt to settle private rights."<sup>212</sup> Instead, "the imposition of Rule 11 sanctions is aimed at effectuating the

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202. FED. R. CIV. P. 11(a), (b).

203. FED. R. CIV. P. 11(c).

204. 203 B.R. 740 (N.D. Okla. 1996).

205. *See id.* at 744.

206. *Id.* at 741.

207. *Id.* at 742.

208. *Id.* (quoting *Alpern v. Lieb*, 11 F.3d 689, 690 (7th Cir. 1993)).

209. *Id.* (quoting *Alpern*, 11 F.3d at 690).

210. *Id.* (quoting *Alpern*, 11 F.3d at 690).

211. *Id.* (quoting *Alpern*, 11 F.3d at 690).

212. *Id.* at 744.

federal judiciary's policy of purging needless, harassing, and abusive litigation from the federal court system."<sup>213</sup> Because of the overwhelming public policy concerns involved, the court held that the proceedings for Rule 11 sanctions passed the public policy test and were excepted from the automatic stay.<sup>214</sup>

### *C. Application to Corporation Commission Forced Poolings*

Analysis of the police power exception as it relates to other administrative proceedings and proceedings for Rule 11 sanctions leads to the conclusion that forced poolings should be excepted from the automatic stay. As *In re Aerobox* and *Maritan* show, even proceedings that seemingly adjudicate private rights can satisfy the public policy test and be excepted from the automatic stay. And, just like in *In re Aerobox*, even though the working interest owner seeking to operate a well by means of a pooling order is arguably the direct beneficiary of the pooling, the primary purpose behind the pooling order remains the effectuation of public policy. Furthermore, even though the private interests involved in a forced pooling are entirely pecuniary, like proceedings for Rule 11 sanctions in *Maritan*, the public policy considerations behind pooling orders arguably outweigh the private rights adjudicated.

Despite all this, *In re Dan Hixson Chevrolet Co.* gives rise to several questions about the true nature of pooling proceedings. Much like the Texas Motor Vehicle Code, the statutes detailing the duties and obligations of the Corporation Commission set forth strong public policy considerations. As the Bankruptcy Court for the Northern District of Texas found, however, the Texas Motor Vehicle Commission proceedings actually adjudicate disputes between private parties to discern each party's respective rights. Similarly, a pooling proceeding is merely an administrative construct that modifies the rights of an individual's mineral estate (transforming a working interest to a royalty interest with cash compensation). Furthermore, the bankruptcy judge in *Dan Hixson Chevrolet* determined that, because the Texas Motor Vehicle Commission proceeding would only affect the parties involved in the proceeding, the agency was acting in a quasi-sovereign capacity even though there were strong public policy considerations behind the proceeding. This mirrors pooling proceedings, where the only rights modified by a pooling order are those of the parties involved in the proceeding.

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213. *Id.*

214. *Id.* at 742.

Although the concerns arising from *Dan Hixson Chevrolet* cast some doubt on the public policy nature of the pooling proceedings, the balance between private rights and public policy tips in favor of the latter. Because pooling proceedings effectuate public policy more than they adjudicate private rights, pooling proceedings should be excepted from the automatic stay.

#### V. Conclusions and Recommendation

Forced poolings implicate the automatic stay and check most, if not all, of the boxes necessary to warrant application of the police power exception. Primarily, a debtor's unleased working interest in a mineral estate forms part of the bankruptcy estate created by 11 U.S.C. § 541.<sup>215</sup> Therefore, the commencement or continuation of a judicial proceeding to obtain possession of or exercise control over a debtor's working interest triggers the automatic stay.<sup>216</sup> A forced pooling is clearly a judicial proceeding that seeks to exercise control over a mineral estate's working interest. Accordingly, unless the police power exception applies, pooling proceedings must be stayed.

A forced pooling likely triggers the police power exception, though, and exempts the proceedings from the automatic stay. First, a forced pooling is clearly a proceeding by a government entity.<sup>217</sup> Second, there are strong public policy concerns associated with not only forced poolings but all conservation proceedings before the Corporation Commission.<sup>218</sup> Third, the Corporation Commission holds no pecuniary interest in a forced pooling—the purpose of the proceeding is merely to allow a willing operator the ability to drill a well in an established spacing unit.<sup>219</sup> Thus, the only characteristic of a forced pooling that could prevent the application of the police power exception is the nature of the rights adjudicated.

The pecuniary purpose test presents an easy enough hurdle to clear: the state of Oklahoma and the Corporation Commission have no pecuniary interest in a debtor working interest owner's bankruptcy estate. Nothing in a forced pooling suggests Oklahoma or the Corporation Commission is motivated by a desire to control the bankruptcy estate for its own gain. It is

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215. 11 U.S.C. § 541(a)(1) (2012). It is important that the mineral interest be unleased; a transferred working interest in gaseous hydrocarbons is not included in the bankruptcy estate. *Id.* § 541(b)(4)(A)(i).

216. 11 U.S.C. §§ 362(a)(1), (3) (2012).

217. 11 U.S.C. § 101(27) (2012).

218. OKLA. ADMIN. CODE § 165:10-1-1 (2016).

219. *See* 52 OKLA. STAT. § 87.1(e) (2011).

a safe assumption, therefore, that forced poolings satisfy the pecuniary purpose test.

The public policy test, however, is less clear regarding the fate of forced poolings. The stated purpose of the oil and gas division of the Oklahoma Corporation Commission is to maximize recovery, prevent waste, and protect correlative rights; undoubtedly, these are public policy considerations.<sup>220</sup> It cannot be ignored, however, that forced poolings are, for all intents and purposes, adjudications of private rights. Any private citizen, publicly traded company, or partnership that owns a working interest in a mineral estate retains the ability and the right to petition the Corporation Commission to let them drill and operate a well within their unit. Yes, drilling the well maximizes recovery. Yes, it is unfair to allow the inability to reach a private agreement or a holdout working interest owner to chill the recovery of hydrocarbons. But do those public policy interests outweigh the highly individualized nature of these conservation proceedings? Forced poolings unquestionably involve the adjudication of private rights. The question, then, is which is more important: the public policy goals of the forced pooling or the private rights? Given the importance of oil and gas exploration to the state of Oklahoma, it is fair to presume that most would conclude the public benefits of pooling and drilling far outweigh any individual rights adjudicated in the process.

The cynical answer to this question is that whether forced poolings fall under the police power exception may prove inconsequential. While bankruptcies for oil and gas producers occur with increasing frequency,<sup>221</sup> the relatively short nature of bankruptcies in the oil and gas industry could render the question moot time and again. Take, for example, SandRidge. SandRidge filed for bankruptcy on May 16, 2016.<sup>222</sup> A mere twenty weeks later, on October 4, 2016, SandRidge emerged from its bankruptcy.<sup>223</sup> In the grand scheme of oil and gas exploration, twenty weeks is no time at all. It is possible that a working interest owner in bankruptcy could emerge from that bankruptcy fast enough that the Corporation Commission need not

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220. There is even an environmental protection argument to be made in support of the public policy behind forced poolings and the application of the police power exception.

221. OIL PATCH BANKRUPTCY MONITOR, *supra* note 8, at 2.

222. *In re SandRidge Energy Inc.*, No. 16-32488 (Bankr. S.D. Tex. May 16, 2016); Erin Ailworth & Stephanie Gleason, *SandRidge Energy Files for Bankruptcy Protection*, WALL ST. J. (May 16, 2016), <http://www.wsj.com/articles/sandridge-energy-files-for-bankruptcy-protection-1463404621>.

223. Adam Wilmoth, *SandRidge Energy Emerges from Bankruptcy*, OKLAHOMAN (Oct. 4, 2016), <http://newsok.com/article/5520992>.

worry about whether forced poolings must be stayed. It is also possible that a working interest owner in bankruptcy, probably an individual, would not object to being pooled and would have no reason to ask the Corporation Commission to enforce the automatic stay.

When the debtor is a corporation, it is easier to justify the adjudication of private rights with “promoting public policy.” In that sense, the Corporation Commission’s conclusions regarding Linn Energy, discussed in the Introduction, seem justified. Linn Energy is a sophisticated and complex corporate entity with billions of dollars in assets and liabilities. Whether one of Linn Energy’s subsidiaries operates a single well in Oklahoma seems less like the adjudication of private rights. In Linn Energy’s case, it seems far more important that a viable company take over operation of the wells in question to maximize recovery and prevent waste.

Consider, however, how the exception might affect an individual or married couple that files a voluntary or joint petition to enter bankruptcy. Perhaps Bob and Jane Smith own working interests in various units throughout the state. Maybe they even have the financial means and contractual savvy to negotiate a JOA with the other working interest owners in their units. Maybe they have every intention of holding onto their working interests and have a chance of keeping them when they emerge from bankruptcy. Even if the Smiths cannot emerge from bankruptcy with their working interests intact, the Smiths’ bankruptcy estate is concretely affected by changing the working interest into a pure royalty interest. A pooling order devalues the Smiths’ bankruptcy estate and prevents the Smiths from paying their creditors as much as they could have when they still owned their working interest. Thus, pooling proceedings seem much more like an adjudication of private rights when they involve individuals that own working interests in units. More likely than not, however, the Smiths simply do not exist.

Although this question may continuously be rendered moot, a chance exists, given the immeasurable number of working interest owners in the state and the number of well operators registered with the Corporation Commission, that some *individual* (as opposed to a corporate) working interest owner somewhere could remain in bankruptcy long enough to be a party to a forced pooling. Because of this possibility, the Corporation Commission should consider how to treat individual working interest owners in bankruptcy. Specifically, the Corporation Commission should consider whether the public policy component of pooling proceedings outweighs the private rights adjudicated when the working interest owner is an individual debtor in bankruptcy. The Corporation Commission’s

decision that pooling proceedings involving a bankrupt corporate working interest owner are exempt from the stay through the police power exception makes perfect sense. Perhaps, however, an argument can be made to halt a forced pooling when the debtor is an individual. With any luck, a sophisticated, individual working interest owner in bankruptcy will choose to contest and appeal a pooling order, allowing a court to finally answer this question. The court could then thoroughly analyze whether the public policy considerations outweigh the private rights of the individual. Until such a time, bankrupt beware: your working interest can still be pooled.

*Connor R. Bourland*