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"Profitable Mineral Management"

BREAKFAST SERIES *for*
Surface and Mineral Owners
Admission by Invitation Only

DATE: **February 2, 2016**

TOPIC: **Bankruptcy**

LOCATION: **San Antonio Petroleum Club**
8620 N New Braunfels, Suite 700
San Antonio, TX 78217-6363
P 210.824.9014
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TIME: 7:30 AM Breakfast - 8:00 AM Presenters
8:50 AM Questions & Answers

INTRODUCTION: **E.O. (Trey) Scott, III, Trinity Mineral Management, Ltd.**

PRESENTERS: **Alex Villarreal, Person, Whitworth, Borchers, and Morales**

UPCOMING:
Mar 01: Kaitlynn Whitman
Apr 05: To Be Announced
May 03: Laura Burney

Alejandro “Alex” E. Villarreal, III

Partner Attorney

PERSON & WHITWORTH
BORCHERS & MORALES LLP
ATTORNEYS AT LAW

Alex attended St. Mary’s University receiving a BBA in Accounting in 1977 and St Mary’s University School of Law receiving his JD in 1980.

He joined the Law Firm as an Associate immediately upon taking the Bar Exam in July of 1980 and has remained with the Law Firm since. Alex became the first Associate to be made a Partner in 1987. For 30 years Alex practiced in the areas of residential and commercial real estate development and at the same time representing South Texas National Bank, The Laredo National Bank and Compass Bank in the area of commercial real estate lending. His experience in the field of Bankruptcy is primarily in the Southern District of Texas covering Houston, Victoria, Laredo and Brownsville. Alex represented the firm’s land and royalty owners in the GHR Energy and TransAmerican Natural Gas Bankruptcies in South Texas. After 30 years of Bankruptcy and practicing before three (3) Bankruptcy Judges who have retired, Alex left the Bankruptcy Court vowing never to return.

Over the last 5 years, Alex has continued his representation of Residential and Commercial Land Developers and represents numerous landowner clients in a wide range of energy related transactions, including oil and gas leases, pipeline rights-of-way, and surface use agreements.

During this period Alex has found the time to become licensed as a Texas General Certified Real Estate Appraiser working for the City of Laredo and the City of Laredo Airport as an expert witness in real property negotiations and condemnation.

ORIGIN:

Ancient world – Greece

Current Bankruptcy did not exist; it was called "Debt Slavery" You, your wife, children and your servants would have to work off your obligations.

England – 1700's and mid 1800's

Creditors would get together and take charge of the farms, finances and the bankruptcy person's lives until they were able to stand back on their feet.

United States – Bankruptcy Act of 1898 established the concepts of Debtors and Creditors.

Bankruptcy Reform Act of 1978 established the Bankruptcy Code.

2005 Act of Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

TYPES OF BANKRUPTCIES:

Chapter 7 and 13 are used to resolve personal debt

Chapter 7 governs the process of liquidation under the bankruptcy laws of the United States. Chapter 7 is the most common form of bankruptcy in the United States.

Federal exemptions is a dollar amount, I believe you can keep up to $22,500.00 of equity, $3,675 for a car, $1,500 for jewelry, and $12,500.00 of stuff.

Texas (State) exemptions Homestead - 1 acre in town, Urban

or 100 acres (200 acres for families), Rural

Personal Property: Athletic and sporting equipment, including bicycles; 2 firearms; home furnishings, including family heirlooms; food; clothing; jewelry; 1 two-three or four wheeled motor vehicle per member of family adult who holds a driver's license;

2 horses, mules or donkeys and a saddle, blanket and bridle for each; 12 head of cattle; 60 head of other types of livestock; 120 fowl; and pets;

All debt is wiped clear (with exceptions) and you get a "fresh start".

Chapter 13 - provides an individual the opportunity to propose a plan of financial while under the protection of the bankruptcy court. The purpose of chapter 13 is to enable an individual with a regular source of income to propose a chapter 13 plan that provides for their various classes of creditors. Usually lasts over a period of up to 5 years.

Chapter 11 – Business Reorganization is a chapter of the United States Bankruptcy Code, which permits reorganization under the bankruptcy laws of the United States. Chapter 11 bankruptcy is available to every business, whether organized as a corporation, partnership or sole proprietorship, and to individuals, although it is most prominently used by corporate entities.

Chapter 9 – Available exclusively to municipalities, to assist them in the restructuring of debts. On July 18, 2013 Detroit, Michigan became the largest city in the history of the United States to file for Chapter 9 Bankruptcy protection.

Chapter 12 – Farmers and Commercial Fishermen. It is similar to Chapter 13 in structure, but it offers additional benefits to farmers and fishermen in certain circumstances, beyond those available to ordinary wage earners. Chapter 12 is applicable only to family farmers and fishermen.

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TERMS YOU NEED TO KNOW

USC § 341 — 341 Meeting 341 meeting is a meeting of creditors conducted in a bankruptcy proceeding which is scheduled about 20 to 40 days after filing for bankruptcy. 341 meeting is essentially a meeting between a debtor and the bankruptcy trustee and the trustee presides over the meeting. There will not be a judge in the 341 meeting. The duration of the meeting is generally 15 minutes and the entire proceedings will be tape recorded or recorded by the court reporter. 341 meetings are also known as the first meeting of creditors.

USC § 362 — Automatic Stay In United States Bankruptcy Law, an Automatic Stay is an automatic injunction that halts actions by creditors, with certain exceptions, to collect debts from a debtor who has declared bankruptcy. Under Section 362 of the United States Bankruptcy Code, the stay begins at the moment the bankruptcy petition is filed.

USC § 363 — Use, Sale or Lease of Property Section 363 of the Bankruptcy Code governs the sales of a debtor's assets outside the ordinary course of business.

USC § 365 — Executory Contracts and Unexpired Leases A provision of the United States Bankruptcy Code that allows the trustee, or debtor-in-possession, in a case under Chapters 9, 11, 12 or 13, to assume or reject an executory contract or lease prior to confirmation, unless the court requires that a decision be made within an earlier, specified period of time upon the application of a contract or lease party.

USC § 501 — Proof of Claim A Proof of Claim is a written statement that sets forth the creditor's claim. Except in Chapter 11 cases, in which certain scheduled claims are deemed filed. A creditor desiring to receive distributions in a bankruptcy case must file a timely Proof of Claim. It must conform substantially to official Form 10, which can be found in the Bankruptcy Rules. I believe it's a better practice to always file a proof of claim.

SO THEY FILED BANKRUPTCY, NOW WHAT?

Post-Bankruptcy Basics

1. You are a Creditor. Is your claim liquidated or unliquidated.
   Are you secured or unsecured.

2. Automatic Stay. Stops in its tracts all efforts to collect a debt.
   Lift the Stay

3. Property of the Estate. Property rights by lease or contract.

4. Usage of Cash Collateral, DIP Financing. Get the Bank happy to continue operations.

5. Executory Contracts / Leases – Oil and Gas lease.

6. Assumption / Rejection of Leases.

7. Disclosure Statement – This is supposed to provide you with sufficient information to make an informative decision about the Plan.

8. Plan The New Reorganized Company

OTHER POSSIBLE BANKRUPTCY ACTIONS

1. Section 363 Sale of Assets / Leases – Stalking horse bid
2. Abandonment of assets – What about plugging duties
3. Avoidance actions

TEXAS STATUES AND CASES.

Texas Uniform Commercial Code Section 9.343

Sec. 9.343. OIL AND GAS INTERESTS: SECURITY INTEREST PERFECTED WITHOUT FILING; STATUTORY LIEN. (a) This section provides a security interest in favor of interest owners, as secured parties, to secure the obligations of the first purchaser of oil and gas production, as debtor, to pay the purchase price. An authenticated record giving the interest owner a right under real property law operates as a security agreement created under this chapter. The act of the first purchaser in signing an agreement to purchase oil or gas production, in issuing a division order, or in making any other voluntary communication to the interest owner or any governmental agency recognizing the interest owner's right operates as an authentication of a security agreement in accordance with Section 9.203(b) for purposes of this chapter.

(b) The security interest provided by this section is perfected automatically without the filing of a financing statement. If the interest of the secured party is evidenced by a deed, mineral deed, reservation in either, oil or gas lease, assignment, or any other such record recorded in the real property records of a county clerk, that record is effective as a filed financing statement for purposes of this chapter, but no fee is required except a fee that is otherwise required by the county clerk, and there is no requirement of refiling every five years to maintain effectiveness of the filing.

(c) The security interest exists in oil and gas production, and also in the identifiable proceeds of that production owned by, received by, or due to the first purchaser:

(1) for an unlimited time if:

(A) the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of those, although the sale of those proceeds by a first purchaser to a buyer in the ordinary course of business as provided in Subsection (e) cuts off the security interest in those proceeds;

(B) the proceeds are accounts, chattel paper, instruments, documents, or payment intangibles; or

(C) the proceeds are cash proceeds, as defined in Section 9.102; and

(2) for the length of time provided in Section 9.315 for all other proceeds.

(d) This section creates a lien that secures the payment of all taxes that are or should be withheld or paid by the first purchaser and a lien that secures the rights of any person who would be entitled to a security interest under Subsection (a) except for lack of any adoption of a security agreement by the first purchaser or a lack of possession or record required by Section 9.203 for the security interest to be enforceable.

(e) The security interests and liens created by this section have priority over any purchaser who is not a buyer in the ordinary course of the first purchaser's business, but are cut off by the sale to a buyer from the first purchaser who is in the ordinary course of the first purchaser's business under Section 9.320(a). But in either case, whether or not the buyer from the first purchaser is in ordinary course, a security interest will continue in the proceeds of the sale by the first purchaser as provided in Subsection (c).

(f) The security interests and all liens created by this section have the following priorities over other Chapter 9 security interests:

(1) A security interest created by this section is treated as a purchase-money security interest for purposes of determining its relative priority under Section 9.324 over other security interests not provided for by this section. A holder of a security interest created under this section is not required to give the written notice every five years as provided in Section 9.324(b)(3) to have purchase-money priority over a security interest with a prior financing statement covering inventory.

(2) A statutory lien is subordinate to all other perfected Chapter 9 security interests and has priority over unperfected Chapter 9 security interests and the lien creditors, buyers, and transferees mentioned in Section 9.317.

(g) The security interests and liens created by this section have the following priorities among themselves:

(1) If a record effective as a filed financing statement under Subsection (b) exists, the security interests perfected by that record have priority over a security interest automatically perfected without filing under Subsection (b). If several security interests perfected by records exist, they have the same priority among themselves as established by real property law for interests in oil and gas in place. If real property law establishes no priority among them, they share priority pro rata.

(2) A security interest perfected automatically without filing under Subsection (b) has priority over a lien created under Subsection (d).

(3) A nontax lien under Subsection (d) has priority over a lien created under that subsection that secures the payment of taxes.

(h) The priorities for statutory liens mentioned in Section 9.333 do not apply to any security interest or statutory lien created by this section. But if a pipeline common carrier has a statutory or tariff lien that is effective and enforceable against a trustee in bankruptcy and not invalidated by the Federal Tax Lien Act, that lien has priority over the security interests and statutory liens created by this section.

(i) If oil or gas production in which there are security interests or statutory liens created by this section is commingled with inventory or other production, the rules of Section 9.336 apply.

(j) A security interest or statutory lien created by this section remains effective against the debtor and perfected against the debtor's creditors even if assigned, regardless of whether the assignment is perfected against the assignor's creditors. If a deed, mineral deed, assignment of oil and gas lease, or other such record evidencing the assignment is filed in the real property records of the county, it will have the same effect as filing an amended financing statement under Section 9.514.

(k) This section does not impair an operator's right to set-off or withhold funds from other interest owners as security for or in satisfaction of any debt or security interest. In case of a dispute between an operator and another interest owner, a good faith tender of funds by anyone to the person who the operator and other interest owner agree on, to a person who otherwise shows himself or herself to be the one entitled to the funds, or to a court of competent jurisdiction in the event of litigation or bankruptcy operates as a tender of the funds to both.

(l) A first purchaser who acts in good faith may terminate an interest owner's security interest or statutory lien under this section by paying, or by making and keeping open a tender of, the amount the first purchaser believes to be due to the interest owner:

(1) if the interest owner's rights are to oil or gas production or its proceeds, either to the operator alone, in which event the operator is considered the first purchaser, or to some combination of the interest owner and the operator, as the first purchaser chooses;

(2) whatever the nature of the production to which the interest owner has rights, to the person that the interest owner agreed to or acquiesced in; or

(3) to a court of competent jurisdiction in the event of litigation or bankruptcy.

(m) A person who buys from a first purchaser can ensure that the person buys free and clear of an interest owner's security interest or statutory lien under this section:

(1) by buying in the ordinary course of the first purchaser's business from the first purchaser under Section 9.320(a);

(2) by obtaining the interest owner's consent to the sale under Section 9.315(a)(1);

(3) by ensuring that the first purchaser has paid the interest owner or, provided that gas production is involved, or the interest owner has so agreed or acquiesced, by ensuring that the first purchaser has paid the interest owner's operator; or

(4) by ensuring that the person or the first purchaser or some other person has withheld funds sufficient to pay amounts in dispute and has maintained a tender of those funds to whoever shows himself or herself to be the person entitled.

(n) If a tender under Subsection (m) (4) that is valid thereafter fails, the security interest and liens governed by this section remain effective.

(o) In addition to the usual remedy of sequestration available to secured parties, and the remedies given in Subchapter F, the holders of security interests and liens created by this section have available to them, to the extent constitutionally permitted, the remedies of replevin, attachment, and garnishment to assist them in realizing upon their rights.

(p) The rights of any person claiming under a security interest or lien created by this section are governed by the other provisions of this chapter except to the extent that this section necessarily displaces those provisions. This section does not invalidate or otherwise affect the interests of any person in any real property before severance of any oil or gas production.

(q) The security interest created under Subsections (a) and (b) do not apply to proceeds of gas production that have been withheld, in cash or account form, by a purchaser under Section 201.204(c), Tax Code.

(r) In this section:

(1) "Oil and gas production" means any oil, natural gas, condensate of either, natural gas liquids, other gaseous, liquid, or dissolved hydrocarbons, sulfur, or helium, or other substance produced as a by-product or adjunct to their production, or any combination of these, which is severed, extracted, or produced from the ground, the seabed, or other submerged lands within the jurisdiction of this state. Any such substance, including recoverable or recovered natural gas liquids,

that is transported to or in a natural gas pipeline or natural gas gathering system, or otherwise transported or sold for use as natural gas, or is transported or sold for the extraction of helium or natural gas liquids is "gas production." Any such substance that is transported or sold to persons and for purposes not included in the foregoing natural gas definition is "oil production."

(2) "Interest owner" means a person owning an entire or fractional interest of any kind or nature in oil or gas production at the time of severance, or a person who has an express, implied, or constructive right to receive a monetary payment determined by the value of oil or gas production or by the amount of production.

(3) "First purchaser" means the first person that purchases oil or gas production from an operator or interest owner after the production is severed, or an operator that receives production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement authenticated by the operator under which the operator collects proceeds of production on behalf of other interest owners. To the extent the operator receives proceeds attributable to the interest of other interest owners from a third-party purchaser who acts in good faith under a division order or other agreement authenticated by such operator, the operator is considered to be the first purchaser of the production for all purposes under this section, notwithstanding the characterization of other persons as first purchasers under other laws or regulations. To the extent the operator has not received from the third-party purchaser proceeds attributable to the operator's interest and the interest of other interest owners, the operator is not considered the first purchaser for the purposes of this section and is entitled to all rights and benefits under this section. Nothing in this section impairs or affects any rights otherwise held by a royalty owner to take its share of oil in kind or receive payment directly from a third-party purchaser for the royalty owner's share of oil production with or without a previously made agreement.

(4) "Operator" means a person engaged in the business of severing oil or gas production from the ground, whether for the person alone, only for other persons, or for the person and others.

Added by Acts 1999, 76th Leg., ch. 414, Sec. 1.01, eff. July 1, 2001.

253 B.R. 808
United States Bankruptcy Court,
S.D. Texas,
Houston Division.

In re TRI–UNION DEVELOPMENT CORPORATION, Debtor.

No. 00–32498–H4–11.
|
Oct. 4, 2000.

Motion was filed, in Chapter 11 case of bankrupt operator of oil and gas wells, for payment of prepetition royalties with respect to oil and gas leases in Texas and California. The Bankruptcy Court, William R. Greendyke, J., held that: (1) debtor was "first purchaser," within meaning of provision of Texas oil and gas law which provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price; (2) statutory liens accorded, under Texas law, to royalty and working interest owners in cash or account proceeds of oil and gas production were not susceptible to being cut off by bona fide purchaser under Texas law, and thus were not subject to avoidance; (3) under California law, royalty owners were not accorded any statutory liens to secure payment of unpaid royalties; and (4) debtor would be allowed to make payment on secured claims of Texas royalty and working interest owners prior to confirmation of plan.

Granted in part and denied in part.

West Headnotes (9)

[1] **Mines and Minerals**
Rights and liabilities as to third persons

Provision of Texas oil and gas law, which provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price, was enacted to protect unpaid interest owners, who would otherwise be accorded mere general unsecured claims in event that operator or oil and gas purchaser filed for bankruptcy relief, by creating security interests in favor of such interest owners to secure payment of purchase price. V.T.C.A., Bus. & C. § 9.319.

2 Cases that cite this headnote

[2] **Mines and Minerals**
Rights and liabilities as to third persons

Ability of royalty owner to rely on provision of Texas oil and gas law, which provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price, does not depend either upon existence of written agreement for attachment of lien or upon filing of financing statement. V.T.C.A., Bus. & C. § 9.319.

1 Cases that cite this headnote

[3] **Mines and Minerals**
Rights and liabilities as to third persons

Royalty owner may rely on provision of Texas oil and gas law, which provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price, as long as there is (1) a writing which gives interest holder a right under real estate law; and (2) act of first purchaser making a voluntary communication to interest owner acknowledging his or her rights to oil and/or gas property or its proceeds. V.T.C.A., Bus. & C. § 9.319.

3 Cases that cite this headnote

[4] **Mines and Minerals**
Rights and liabilities as to third persons

Debtor was "first purchaser," within meaning of provision of Texas oil and gas law which provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price, to extent that debtor, in its capacity as operator of oil and gas wells, received production proceeds on behalf of royalty owners from third party purchasers. V.T.C.A., Bus. & C. § 9.319.

2 Cases that cite this headnote

[5] **Mines and Minerals**
Rights and liabilities as to third persons

Term "interest owner," as used in provision of Texas oil and gas law that provides for security interest in favor of interest owners to secure obligations of first purchaser of oil and gas production for payment of purchase price, is to be given expansive definition, and would seem to clearly include all royalty and working interest owners. V.T.C.A., Bus. & C. § 9.319.

1 Cases that cite this headnote

[6] **Bankruptcy**
Statutory Liens
Mines and Minerals
Rights and liabilities as to third persons

Statutory liens that were accorded, under Texas law, to royalty and working interest owners in cash or account proceeds of oil and gas production, in order to secure debtor's obligation, as operator of oil and gas wells, for payment of purchase price, were not susceptible to being cut off by bona fide purchaser under Texas law, and thus were not subject to avoidance pursuant to bankruptcy statute dealing with statutory liens. Bankr.Code, 11 U.S.C.A. § 545(2); V.T.C.A., Bus. & C. § 9.319.

1 Cases that cite this headnote

[7] **Mines and Minerals**
Rights and liabilities

Statutory liens that are accorded, under Texas law, to royalty and working interest owners in production of oil and gas wells run in favor of all interest owners, and not just interest owners in kind. V.T.C.A., Bus. & C. § 9.319.

Cases that cite this headnote

[8] **Mines and Minerals**
Rights and liabilities

Under California law, royalty owners with respect to oil and gas leases are not accorded any statutory liens to secure payment of unpaid royalties; rather, royalty owners' one recourse for unpaid royalties is through litigation.

Cases that cite this headnote

[9] **Bankruptcy**
Payment; interim awards
Bankruptcy
Cash Collateral, Use of

Chapter 11 debtor, in its capacity as operator of oil and gas wells, would be allowed to make payment on secured claims of Texas royalty and working interest owners prior to confirmation of plan of reorganization; debtor's payments, from cash collateral that it was statutorily required to segregate for benefit of royalty and working interest owners, were in nature of abandonment of cash collateral in which it had no equity, and whose retention would be burdensome to estate.

1 Cases that cite this headnote

Attorneys and Law Firms

*810 Mr. Joel Kay, Sheinfeld, Maley & Kay, Houston, TX, for Debtor.

MEMORANDUM OF DECISION

WILLIAM R. GREENDYKE, Bankruptcy Judge.

This matter came before the Court on May 17, 2000, on the above-styled Motion. At the conclusion of the hearing, the Court entered an Interim Order which authorized the payment of the prepetition royalties with respect to Louisiana oil and gas leases and prepetition royalties with respect to the Lohse oil and gas lease in California. The remaining aspects of the Motion requesting payment of prepetition royalties with respect to oil and gas leases in Texas and the other oil and gas leases in California were taken under advisement.

FACTUAL BACKGROUND

The Debtor operates oil and gas wells in Texas, Louisiana, California and offshore Texas and Louisiana. Its properties are the subject of over 1,000 oil and gas leases which are to be construed in accordance with the law of the State in which the property is located (with the exception of the offshore leases, which are governed by federal law and administered by the Minerals Management Service). The Debtor has represented to the court that prior to March 14, 2000, the date of filing of the Chapter 11, the Debtor was "generally current" in the payment of all royalty and working interest obligations. Unfortunately, in the course of payment, approximately 950 checks issued between September 1999 and March 1, 2000, had not been presented for payment prior to the date of filing. These unpaid checks total $296,961.13. Further, as of the petition date, the Debtor had received proceeds of oil and gas production which had not been processed through Debtor's accounting system for final payment. These proceeds totaled $201,271.13. Debtor now seeks permission to pay these prepetition claims. Although several creditors and the Unsecured Creditors' Committee objected to the Debtor's motion, upon hearing, the parties consented to payment of the prepetition royalties with respect to the Louisiana oil and gas leases and the Lohse oil and gas lease in California. The Debtor withdrew its request to pay prepetition working interest owners. An interim order was then entered to implement the agreements made, subject to the Court's ruling herein.

With respect to the Texas leases, the general question presented to the Court was whether these royalty interest owners *811 hold a security interest. This question requires an examination of section 9.319 of the Texas Business & Commerce Code, which provides for: "a security interest in favor of interest owners (as secured parties) to secure the obligations of the first purchaser of oil and gas production (as debtor) to pay the purchase price." The specific issues presented are whether 1) the debtor qualifies as a first purchaser and if so, 2) does the statute cover all royalty owners' claims, that is, both those royalty owners who take their royalty in kind as well as those who are paid money for their royalty?

The debtor argues that it is indeed a "first purchaser" as that term is defined and that the royalty owners hold an automatically perfected security interest in the oil and gas production and also in the proceeds of such production currently being held by the debtor.

The Creditor's Committee argues that section 9.319 does not apply to all royalty owners but instead to royalty owners who take their production in kind. The Committee argues since the statute only "secure[s] the obligations of the first purchaser of oil and gas production to pay the purchase price," this would cover only the first purchaser incurring an obligation to pay the "purchase price." Thus, the security interest should only be in favor of the party actually selling the production. Royalty owners typically agree to let the operator sell the oil or gas at the well head for their account. Since such a royalty owner is not selling anything, it is argued that the security interest should not attach in such situations. A royalty owner who takes in kind, however, would receive a security interest, since they are receiving production which in turn is sold by the royalty owner to a third-party "first purchaser."

DISCUSSION

[1] [2] [3] [4] Resolution of these issues requires an examination of the reasons for the existence of section 9.319 of the Texas Business and Commerce Code. Prior to 1983, the Texas version of the U.C.C. did not contain a section 9.319. However, the Texas Legislature responded to the (first) "oil and gas bust" of the early '80's by enacting the non-standard language we now know as section 9.319. The bankruptcies of several large oil and gas operators and purchasers had a considerable impact on Texas royalty and non-operating working interest owners and the new provisions were designed to protect

those interests.[1] In the absence of a statute such as section 9.319, the breach of contract or tort cause of action of an unpaid royalty owner would become a general unsecured claim in the bankruptcy of the operator or oil and gas purchaser.[2] The new statute was designed to change this result through the creation of a security interest in favor of interest owners to secure the obligation of the first purchaser of oil and gas production to pay the purchase price.[3] The ability of the royalty owner to rely upon section 9.319 does not depend upon the existence of either a written agreement for attachment of the lien or the filing of a financing statement. There merely has to be: 1) a writing which gives the interest holder a right under real estate law (i.e. a deed, oil and gas lease, mineral assignment, etc.); and 2) the act of the first purchaser making a voluntary communication to the interest owner acknowledging his or her rights to the oil and/or gas property or its proceeds.[4]

In the case at bar, there has been no assertion that any of the ostensible royalty owners fail to possess sufficient written evidence or muniment of title. Similarly, ***812** the evidence at trial was that the Debtor receives "100 percent division orders" from its oil and gas purchasers. That is to say, with the exception of a few royalty owners who take in kind, the Debtor receives the income attributable to 100% of the production, with the concomitant duty to disburse to its working interest and royalty interest owners. The facts of this case squarely place these royalty owners within the protective terms of section 9.319 of the Texas Business and Commerce Code.

The "in kind only" argument propounded by the Creditor's Committee may have been plausible as the statute was originally written. However, in 1987, the Texas Legislature amended the definition of first purchaser so that it would include: "... an operator that receives production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement signed by the operator under which the operator collects proceeds of production on behalf of other interest owners."[5] The 1987 amendments went further to provide that the operator acting on behalf of interest owners would be the first purchaser to the extent it had received proceeds from the down-stream buyer, but that if the operator was unpaid at the time of insolvency, etc., then the downstream buyer would continue to be the first purchaser, so that the interest and royalty owners would continue to have a lien.[6] Clearly, the Legislature intended to protect those royalty owners who typically allow their royalties to be paid by the operator in funds rather than in kind.

The Court concludes that the debtor is a "first purchaser" as that term is defined in section 9.319(q)(3).[7] The debtor clearly falls within this section to the extent it acted as an operator who received, on behalf of royalty owners, production proceeds from third party purchasers. Similarly, all royalty owners, whether taking in kind or in funds, would enjoy the protection of a lien in production or proceeds.

[5] The Court now turns to the next question of who exactly is covered by the term "interest owner." The answer to this question seems clear from the reading of the statute. The first sentence grants a security interest in favor of "interest owners." Section 9.319(q)(2) broadly defines "interest owner" as a "person owning an entire or fractional interest of any kind or nature in oil or gas production at the time of severance, or a person who has an express, implied, or constructive right to receive a monetary payment determined by the value of oil or gas production or by the amount of production."[8] As one commentator has written, "[o]wners of unleased mineral interests, working interests, royalty interests, overriding royalty interests and most forms of production payments are clearly included within those persons having 'ownership' interests. The second part of the definition is very broad and therefore should be given an expansive interpretation."[8] The Court is in agreement with the author that the definition should be given an expansive definition. Consequently, this definition would seem to ***813** clearly include all royalty and working interest owners.

[6] The Committee also asserts that, arguendo, even if the Texas royalty owners did have secured claims by virtue of section 9.319, then the liens would be avoidable under 11 U.S.C. § 545(2) because the royalty lien is a statutory lien and as such is not effective against purchasers in the ordinary course of business. Section 545(2) of the Bankruptcy Code provides that: "[the Debtor] may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien—... (2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property, whether or not such a purchaser exists;...." The Committee points out that section 9.319(c)(1)(A) provides that the "sale of such proceeds" by a first purchaser to a buyer [of the proceeds] in the ordinary course will cut off the security interest in the proceeds which otherwise would inure to the benefit of the interest holder. The implication of the argument is that the sale of oil and gas by Tri–Union to an oil and gas purchaser in the ordinary course would cause the forfeiture of the royalty owners lien position under state law. Consequently, because Bankruptcy law supplies this hypothetical good faith buyer, then the liens, if any, of the royalty owners would

be avoidable by "the trustee" (debtor in possession). The first and most obvious flaw in this argument is that the debtor has prudently chosen not to attempt to avoid these royalty liens—it is seeking to adequately protect not only the collateral interests of the royalty owners, but also its own image by filing this motion to pay. Second, and more importantly, the subsection of section 9.319 relied upon relates to the duration of the security interest in proceeds and not the validity of the lien in the first instance.[9]

Taken out of context, the clause cited by the Committee seems to support the argument it makes. However, when subsection (c) is viewed as a whole, it becomes apparent that the security interest which is at risk of being lost to a bona fide purchaser arises only when the oil and gas production has been converted or traded for other "oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of these, ..."[10] When, however, the proceeds are either accounts or cash proceeds, the security interest exists "for an unlimited time."[11] The Committee's statutory ***814** lien argument is inapposite because of this construction of section 9.319. Simply stated, under section 9.319, the liens of the royalty and working interest owners in the production of its cash or account proceeds were perfected and enforceable as of the date of filing and were not susceptible to being cut off by a bona fide purchaser under state law or section 545 of the Bankruptcy Code.

[7] The Court can find no distinction in the statute between an interest holder who receives a share of production in kind and one who receives only cash proceeds. The security interest runs in favor of all interest owners (as defined) and not just interest owners in kind. Comment 5 to the statute discusses the lack of distinction between takers in production and takers in proceeds. "People in the business of dealing with operators and 'first purchasers' are substantially aware that royalty owners and the like always exist and have a claim to the production. No unfair surprise will result if their claim also extends to proceeds."[12] The Court declines to read the statute so narrowly as suggested by the Committee. A narrow construction would go against the "expansive interpretation" which the statute seems to require. Accordingly, the Court finds that the Texas royalty owners hold security interests in production and proceeds thereof.

[8] Turning to the remaining California oil and gas leases, the Court can find no statutory authority which would provide a lien or other security interest for royalty and working interest owners. It seems that California does not provide statutory liens for royalty owners with respect to oil and gas leases. California royalty owners have only one recourse for unpaid royalties and that is through litigation, which is stayed in the case due to the operation of 11 U.S.C. § 362.[13]

[9] The final question to be addressed is the propriety of the debtor making payment of any of the royalty or working interest claims prior to confirmation of a plan of reorganization. The Fifth Circuit, in the case of *In the Matter of Oxford Management Inc.,*[14] specifically held that the payment of a prepetition claim prior to confirmation of a Chapter 11 plan was contrary to the provisions of the Code. Indeed, this Court in the context of other Chapter 11 cases has ruled that it is improper under the current Code and caselaw for the debtor, pre-confirmation, to cross-collateralize or "refinance and re-collateralize" a prepetition secured debt secured by substantially all of the debtor's assets.[15] In the context of this case, however, the facts bear some distinction. First, all of the interests in question are cash collateral in nature. To that extent, the debtor is under a statutory obligation to segregate and account for the collateral of the royalty and working interest owners.[16] Second, the debtor cannot use the cash for any other purpose without court order and without affording adequate protection ***815** for the interests of the royalty and working interest owners.[17] If the oil and gas interest owners had filed a motion to lift the stay to allow them to retake the funds and the debtor did not object, the Court would grant the motion. In this case, the debtor has proposed this result and, except for the objection of the Committee that the interest owners may not be secured creditors under state law, there is no objection to the relief requested with respect to the Texas royalty owners and the Louisiana and limited California interests made the object of the Interim Order. The Court assumes, therefore, that the cash collateral is not necessary to the effective reorganization of the debtor, that there is no equity in the cash collateral for the benefit of the estate and that further retention of the funds would be burdensome to the estate and as such they can be abandoned (read: "paid").[18]

To conclude, since Texas provides for a security interest in favor of interest owners (as that term is defined), the Debtor is authorized to pay the prepetition royalties with respect to the Texas oil and gas leases. As California does not provide its royalty owners with a lien, there is no authority for the debtor to pay these unsecured royalty interest owners at this time. They must wait to receive any distribution until after a plan has been proposed and confirmed.

By separate form of order, the Court shall finalize the interim order, grant Debtor's motion as to the Texas

royalties and deny the motion as to the California royalties not dealt with in the interim order.

All Citations

253 B.R. 808, 150 Oil & Gas Rep. 159

Footnotes

1 *See* Cynthia C. Grinstead, *The Effect of Texas U.C.C. Section 3.19 on Oil and Gas Secured Transactions,* 63 TEX. L.REV. 311 (1984).

2 *See id.* at 317.

3 *See id.* at 323.

4 *See* TEX. BUS. & COM. CODE § 9.319(a)(1991).

5 TEX. BUS. & COM. CODE § 9.319(q)(3)(1991).

6 *See id.*

7 This section, in complete form, defines "first purchaser" as "[A]n operator that receives production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement signed by the operator under which the operator collects proceeds of production on behalf of other interest owners. To the extent the operator receives proceeds attributable to the interest of other interest owners from a third-party purchaser who acts in good faith under a division order or other agreement signed by such operator, the operator shall be considered to be the first purchaser of the production for all purposes under this section, notwithstanding the characterization of other persons as first purchasers under other laws or regulations...."

8 Terry Cross, *Oil and Gas Product Liens-statutory Security Interests for Producers and Royalty Owners under the Statutes of Kansas, New Mexico, Oklahoma, Texas and Wyoming,* 50 CON. FIN. L.Q. REP. 418 (1996).

9 Subsection 9.319(c) in its entirety reads:

> The security interest exists in oil and gas production, and also in the following proceeds of such production owned by, received by, or due to the first purchaser:
> (1) for an unlimited time if:
> (A) the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of these, although the sale of such proceeds by a first purchaser to a buyer in the ordinary course of business as provided in Subsection (e) will cut off the security interest in those proceeds;
> (B) the proceeds are accounts, chattel paper, instruments, and documents; or
> (C) the proceeds are "cash proceeds" as defined in Section 9.306 of this code; and
> (2) for the length of time provided by Section 9.306 of this code as to all other proceeds.

10 TEX. BUS. & COMM. CODE § 9.319(c)(1)(A)(1991).

11 TEX. BUS. & COMM. CODE § 9.319(c)(1) (1991). Indeed, it is again apparent from the Legislature's response to "current events" such as adverse judicial rulings that it clearly intends for royalty and working interest owner's security interests in proceeds to remain inviolate. In the case of *In re The Prudential Energy Company,* 58 B.R. 857 (Bankr.S.D.N.Y.1986), a New York Bankruptcy Judge found that section 9.306 of the Texas Business and Commerce Code limited the secured party's interest when the proceeds of the royalty were commingled with the other funds of the debtor, to the maximum amount of the royalty funds received by the debtor within the last ten days before the entry of the order for relief under Title 11 of the United States Code. In that case, the royalty owners either were unable or failed to prove the amount of royalty proceeds received within 10 days and their claims were held to be unsecured. The Texas Legislature responded by amending section 9.306 to add subsection 9.306(d)(5), which had the apparent effect of excluding section 9.319 liens from the general provisions of section 9.306 relative to insolvency proceedings. The 9.319 liens now extend to all cash and deposit accounts of the debtor in which royalty or working interest proceeds have been commingled. In the case at bar, no argument has been made about the commingling of funds, the

applicability of 9.306, or the need for tracing of funds. Consequently, any potential statutory lien argument which could arise in such a situation simply does not confront us today.

12 TEX. BUS. & COMM. CODE § 9.319 [comm. 5] (1991).

13 For an example of other states which have enacted oil and gas lien statutes, see the Oil & Gas Products Lien Act, N.M. STAT. ANN. § 48–9–1– § 48–9–8 (Michie 1978); Oil & Gas Owners' Lien Act, OKLA. STAT. ANN. tit. 52 §§ 548–548.6 (West 1988); KAN. STAT. ANN. § 55–201– § 55–229 (1994).

14 *See Chiasson v. J. Louis Matherne & Assoc. (In the Matter of Oxford Mgmt. Inc.),* 4 F.3d 1329 (5th Cir.1993).

15 *See Shapiro v. Saybrook Mfg. Co. Inc. (In the Matter of Saybrook Mfg. Co., Inc.),* 963 F.2d 1490 (11th Cir.1992).

16 11 U.S.C. § 363 (1994).

17 11 U.S.C. § 363 (1994).

18 11 U.S.C. § 362 (1994).

End of Document

407 B.R. 82
United States Bankruptcy Court,
D. Delaware.

In re SEMCRUDE, L.P., et al., Debtors.
Mull Drilling Company, Inc., et al., Plaintiffs,
v.
SemCrude, L.P., et al., Defendants.

Bankruptcy No. 08–11525 (BLS).
|
Adversary No. 08–51446.
|
June 19, 2009.

Synopsis

Background: Kansas oil and gas producers brought adversary proceeding for declaratory relief in Chapter 11 cases of debtors-first purchasers, seeking determinations as to their rights, status, and relative priority of interests in crude oil and natural gas sold to debtors prepetition and proceeds thereof. Parties filed cross-motions for summary judgment.

Holdings: The Bankruptcy Court, Brendan Linehan Shannon, J., held that:

[1] under Kansas law, as predicted by court, subsection of Kansas statute creating security interest in oil and gas production and proceeds thereof that addresses filing of affidavit of production gives parties the same rights they would have had if they had filed financing statement covering "as-extracted collateral" under state law;

[2] under Kansas law, as predicted by court, general rules regarding purchase money security interests (PMSIs) are not displaced by statute creating security interests in oil and gas production and its proceeds;

[3] Delaware's choice of law rules regarding perfection and priority of security interests applied to producers' claims;

[4] law of the location of relevant debtor governed perfection of producers' claimed security interests to the extent that, as of petition date, debtor had possession of oil and gas originating from producers or proceeds therefrom in the form of exchanged oil or gas;

[5] law of the location of relevant debtor governed perfection of producers' claimed security interests in oil and gas proceeds held in form of accounts receivable;

[6] Oklahoma law governed perfection of producers' claimed security interests in cash proceeds; and

[7] as a matter of first impression, security interest perfected only in Kansas pursuant to Kansas statute will be subordinate to a security interest that was duly perfected against debtors in the appropriate state.

Motions for summary judgment granted in part and denied in part.

West Headnotes (36)

[1] **Mines and Minerals**
Requisites and validity

Mineral rights may be severed from the fee simple absolute ownership of property and thus owned separately from the surface interest under Kansas law.

Cases that cite this headnote

[2] **Declaratory Judgment**
Nature and scope of remedy
Declaratory Judgment
Nature and elements in general

Declaratory relief is available to settle actual controversies before they ripen into violations of a law or a breach of duty, and is appropriate where there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality.

Cases that cite this headnote

[3] **Federal Courts**
Inferior courts
Federal Courts
Anticipating or predicting state decision

When a federal court sets out to predict state law, it sits, in effect, as a state supreme court, and any relevant decisions of that state's own lower courts must be researched thoroughly and given great weight, at least in the absence of convincing evidence showing that the state supreme court would not follow them.

1 Cases that cite this headnote

[4] **Federal Courts**
State constitutions, statutes, regulations, and ordinances

When deciding issue of state law, federal court employs state's rules of statutory construction.

1 Cases that cite this headnote

[5] **Statutes**
Language

Under Kansas law, fundamental rule governing statutory interpretation is that the intent of the legislature governs if that intent can be ascertained, and the legislature is presumed to have expressed its intent through the language of the statutory scheme it enacted.

Cases that cite this headnote

[6] **Statutes**
Plain language; plain, ordinary, common, or literal meaning

Under Kansas law, when the language of a statute is plain and unambiguous, court need not resort to statutory construction.

Cases that cite this headnote

[7] **Statutes**
Plain language; plain, ordinary, common, or literal meaning

Under Kansas law, when the language of a statute is plain and unambiguous, an appellate court is bound to implement the expressed intent.

Cases that cite this headnote

[8] **Statutes**
In general; factors considered

Under Kansas law, if the face of a statute leaves its construction uncertain, the court may look to the historical background of the enactment, the circumstances attending its passage, the purpose to be accomplished, and the effect the statute may have under the various constructions suggested.

Cases that cite this headnote

[9] **Statutes**
Giving effect to entire statute and its parts; harmony and superfluousness
Statutes
Unintended or unreasonable results; absurdity

Under Kansas law, courts should generally construe statutes to avoid unreasonable results and should presume that the legislature does not intend to enact useless or meaningless legislation.

Cases that cite this headnote

[10] **Statutes**
Construing together; harmony
Statutes
Superfluousness
Statutes
Conflict

Under Kansas law, court must determine the legislature's intent behind particular statutory language from a general consideration of the entire act, and effect must be given, if possible, to the entire act and every part thereof; to this end, it is the duty of the court, as far as practicable, to reconcile the different provisions so as to make them consistent, harmonious, and sensible.

Cases that cite this headnote

[11] **Statutes**
General and specific statutes

If, under Kansas law, a general and a specific statute cannot be construed in harmony, the specific statute will control unless it is clear that the legislature wanted the general statute to control.

Cases that cite this headnote

[12] **Mines and Minerals**
Rights and liabilities as to third persons

Perfected security interest arising under Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation does not require actual written security agreement or filing of actual financing statement, and, instead, the security interest arises upon either (1) an agreement to purchase oil or gas production, (2) the issuance of a division order, or (3) any other voluntary communication meeting statutory requirements, and is perfected upon the filing of an affidavit of production or its equivalent. K.S.A. 84–9–339a(a).

Cases that cite this headnote

[13] **Mines and Minerals**
Rights and liabilities as to third persons

Under Kansas law, as predicted by Delaware bankruptcy court, subsection of Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation which states that filing of affidavit of production "is effective as a financing statement covering as-extracted collateral" indicates that filing of affidavit of production gives parties the same rights that they would have had if they had filed financing statement covering "as-extracted collateral" under state law, and does not limit security interest granted by statute to security interests arising in as-extracted collateral. K.S.A. 84–9–339a(b), 84–9–501.

Cases that cite this headnote

[14] **Mines and Minerals**
Rights and liabilities as to third persons

Under Kansas law, as predicted by Delaware bankruptcy court, general rules regarding purchase money security interests (PMSIs) set forth in state statute governing priority of PMSIs are not displaced by provision of Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation which indicates that security interests created under such statute are to be treated as "purchase money security interests for purposes of determining their relative priority" under PMSI priority statute, and therefore general rules under PMSI priority statute govern statute creating security interest in oil and gas production. K.S.A. 84–9–324,

84–9–339a(f)(1).

Cases that cite this headnote

[15] **Bankruptcy**
Liens
Mines and Minerals
Rights and liabilities as to third persons

Pursuant to Kansas statute governing priority of purchase money security interests (PMSIs), PMSI priority granted to Kansas oil and gas producers under statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation was limited to inventory on hand at the time Chapter 11 debtor-first purchasers filed their bankruptcy petitions, any identifiable cash proceeds that debtors received prior to delivery of oil and gas production to subsequent purchaser, and certain chattel paper. K.S.A. 84–9–324(b), 84–9–339a(c), (f)(1).

Cases that cite this headnote

[16] **Secured Transactions**
Unperfected Security Interests, Priority Over

To the extent that creditors possess unperfected security interests, they will be subordinate to a perfected security interest in the same collateral under priority rules for secured transactions established by Kansas's version of Uniform Commercial Code (UCC). K.S.A. 84–9–322(a)(2).

Cases that cite this headnote

[17] **Bankruptcy**
Subordination
Secured Transactions
Unperfected Security Interests, Priority Over

To the extent that Delaware law governs perfection and creditors fail to perfect security interests in Delaware before the relevant debtor files bankruptcy, such creditors will be subordinate to a creditor who has a perfected security interest in the collateral under priority rules of Delaware's version of Uniform Commercial Code (UCC). 6 Del.C. § 9–322(a)(2).

Cases that cite this headnote

[18] **Secured Transactions**
Unperfected Security Interests, Priority Over

An unperfected security interest will be subordinate to a perfected security interest under priority rules of Oklahoma's version of Uniform Commercial Code (UCC). 12A Okl.St.Ann. § 1–9–322.

Cases that cite this headnote

[19] **Action**
What law governs

When two states have a connection to a case and an issue arises on which the states' respective laws differ, a choice of law must be made.

Cases that cite this headnote

[20] **Bankruptcy**
Application of state or federal law in general

In the absence of a specific federal policy or interest dictating the use of federal choice of law rules, a bankruptcy court faced with the issue of which substantive state law to apply to a claim for relief in an adversary proceeding applies the choice of law rules of the forum state.

Cases that cite this headnote

[21] **Bankruptcy**
Application of state or federal law in general

Given that federal law may not be applied to questions which arise in federal court but whose determination is not a matter of federal law, state choice of law rules must be applied in adversary proceedings in bankruptcy court.

Cases that cite this headnote

[22] **Bankruptcy**
Particular cases and problems
Bankruptcy
Liens

As the law of the forum state, Delaware's choice of law rules regarding perfection and priority of security interests under Uniform Commercial Code (UCC) applied to claims of Kansas oil and gas producers in adversary proceeding to determine, inter alia, perfection and relative priority of producers' security interests in oil and gas production and its proceeds; bankruptcy court was not free to disregard UCC's choice of law rules and engage in its own ad hoc assessment of which states had most significant contacts. 6 Del.C. § 9–301.

1 Cases that cite this headnote

[23] **Mines and Minerals**
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Kansas oil and gas producers claimed consensual security interests that arose by contract, not statutory liens or similar statutory interests, in asserting security interests under Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, and therefore claimed security interests fell within scope of secured transactions article of Delaware's version of Uniform Commercial Code (UCC) and were subject to Delaware's UCC provision governing choice of law determinations with respect to non-uniform UCC amendments regarding perfection and priority of security interests, such as Kansas statute. K.S.A. 84–9–339a(a); 6 Del.C. §§ 9–109(a)(1), 9–301.

Cases that cite this headnote

[24] **Mines and Minerals**
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Provision of Delaware's version of Uniform Commercial Code (UCC) indicating that, generally, Delaware's secured transactions article did not apply to the extent that a statute of another state, foreign country, or governmental unit of another state or foreign country expressly governed creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit addressed only governmental debtors, and thus did not apply to preclude application of Delaware's UCC provision governing choice of law determinations to Kansas's non-uniform UCC provision creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation. 6 Del.C. §§ 9–109(c)(3), 9–301; K.S.A. 84–9–339a(a).

Cases that cite this headnote

[25] **Mines and Minerals**
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Delaware's version of Uniform Commercial Code (UCC) did not defer to other states' non-uniform UCC provisions governing oil and

gas production, even though UCC official comment indicated that uniform solution to such oil and gas interests was not feasible and was left to "other legislation," and therefore Delaware's UCC provision governing choice of law determinations with respect to non-uniform UCC amendments regarding perfection and priority of security interests applied to Kansas's non-uniform UCC provision creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation. 6 Del.C. §§ 9–301, 9–320(d), 9–320 comment; K.S.A. 84–9–339a.

2 Cases that cite this headnote

[26] **Bankruptcy**
Particular cases and problems
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Under choice of law provision of Delaware's version of Uniform Commercial Code (UCC), law of the location of debtor-first purchaser governed perfection of security interests claimed by Kansas oil and gas producers under Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation to the extent that, as of date of debtor's Chapter 11 filing, debtor had possession of oil and gas originating from producers or proceeds therefrom in the form of exchanged oil or gas. 6 Del.C. § 9–301; K.S.A. 84–9–339a(a).

Cases that cite this headnote

[27] **Bankruptcy**
Particular cases and problems
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Under choice of law provision of Delaware's version of Uniform Commercial Code (UCC), law of the location of debtor-first purchaser governed perfection of security interests claimed by Kansas oil and gas producers, pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, in proceeds of oil and gas production held in form of accounts receivable as of date on which debtor filed its Chapter 11 petition. 6 Del.C. § 9–301; K.S.A. 84–9–339a(a).

Cases that cite this headnote

[28] **Bankruptcy**
Particular cases and problems
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Pursuant to choice of law provision of Delaware's version of Uniform Commercial Code (UCC), Oklahoma law, as law of the place of bank office in which cash of Chapter 11 debtors-first purchasers was held as of debtors' petition date, governed perfection of security interests in cash proceeds from oil and gas production held by debtors in bank accounts that were claimed by Kansas oil and gas producers pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation. 6 Del.C. §§ 9–301, 9–304(a, b); K.S.A. 84–9–339a(a).

Cases that cite this headnote

[29] **Bankruptcy**
Particular cases and problems
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Product of Kansas oil and gas producers did not fit within definition of "as-extracted collateral"

under Delaware's version of Uniform Commercial Code (UCC), and therefore exception, for security interests in as-extracted collateral, to choice of law provision of Delaware's UCC generally governing perfection of security interests did not apply to producers' claimed security interests in oil and gas production sold to Chapter 11 debtors and proceeds thereof. 6 Del.C. § 9–301(4); K.S.A. 84–9–339a(a).

1 Cases that cite this headnote

[30] **Bankruptcy**
Place and time
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
Place of filing
Secured Transactions
Financing Statement

Under both Delaware and Oklahoma law, pursuant to each state's version of Uniform Commercial Code (UCC), Kansas oil and gas producers had to file UCC financing statements in such state to perfect their security interests in oil and gas production sold to Chapter 11 debtors as first purchasers, and in proceeds thereof, pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation. 6 Del.C. § 9–310(a); 12A Okl.St.Ann. § 1–9–310(a).

Cases that cite this headnote

[31] **Bankruptcy**
Liens
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Under choice of law provision of Delaware's version of Uniform Commercial Code (UCC), law of the location of debtor-first purchaser governed determination of priority, as against competing interests, of security interests claimed by Kansas oil and gas producers, pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, in proceeds of their oil and gas production held in form of accounts receivable as of date on which debtor filed its Chapter 11 petition. 6 Del.C. § 9–301; K.S.A. 84–9–339a(a).

Cases that cite this headnote

[32] **Bankruptcy**
Liens
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Pursuant to choice of law provision of Delaware's version of Uniform Commercial Code (UCC), under which local law of jurisdiction in which goods were located governed priority of nonpossessory security interest in such collateral, law of the state in which collateral was located as of date on which Chapter 11 debtor-first purchaser filed its bankruptcy petition governed priority of claimed security interests, under Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, of Kansas oil and gas producers to the extent that debtor held, as of petition date, producers' product or exchanged oil or gas proceeds. 6 Del.C. § 9–301(3)(C); K.S.A. 84–9–339a(a).

Cases that cite this headnote

[33] **Bankruptcy**
Liens
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Pursuant to choice of law provision of Delaware's version of Uniform Commercial Code (UCC), Oklahoma law, as law of place in which bank accounts of Chapter 11 debtors-first purchasers were located, governed priority of security interests claimed by Kansas oil and gas producers, pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, in cash proceeds from oil and gas production held by debtors in bank accounts as of their bankruptcy petition date. 6 Del.C. § 9–304; K.S.A. 84–9–339a(a).

1 Cases that cite this headnote

[34] **Bankruptcy**
Liens
Mines and Minerals
Rights and liabilities as to third persons
Secured Transactions
What Law Governs

Assuming that Kansas oil and gas producers that sold product to Chapter 11 debtors, as first purchasers, had perfected security interests in product and proceeds thereof under Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation, pursuant to Delaware's choice of law rules, Kansas law governed only priority of producers' security interests in product or proceeds in the form of exchanged oil or gas held by debtors in Kansas as of debtors' bankruptcy petition date. K.S.A. 84–9–339a(a); 6 Del.C. §§ 9–301, 9–304.

3 Cases that cite this headnote

[35] **Mines and Minerals**
Rights and liabilities as to third persons
Secured Transactions
Conflicting Security Interests, Priorities Among

Security interest perfected only in Kansas pursuant to Kansas statute creating security interest in oil and gas production and proceeds thereof to secure first purchaser's payment obligation will be subordinate to a security interest that was duly perfected against debtor-first purchasers in the appropriate state. K.S.A. 84–9–339a(a).

Cases that cite this headnote

[36] **Bankruptcy**
Petition for leave; appeal as of right; certification

Sua sponte certification for direct appeal from bankruptcy court to Court of Appeals was warranted as to issue of whether security interest in assets of Chapter 11 debtor-first purchasers held by Kansas oil and gas producers and perfected only in Kansas were subordinate to security interests duly perfected against debtors in appropriate states; there was no governing law on issue and prompt consideration of appeal could serve to advance bankruptcy proceedings, particularly given recently filed plan of reorganization and debtors' expressed intention to seek plan confirmation and emerge from bankruptcy within less than one year. 28 U.S.C.A. § 158(d)(2); K.S.A. 84–9–339a(a).

2 Cases that cite this headnote

*88 ***OPINION*** [1]

BRENDAN LINEHAN SHANNON, Bankruptcy Judge.

Before the Court are a number of cross-motions for summary judgment on a complaint seeking declaratory relief. These include the Plaintiffs' Motion for Summary Judgment on Phase I Issues [Docket No. 161], filed by certain Kansas producers of oil and gas (the "Kansas Producers"); Bank of America, N.A.'s Motion for Summary Judgment on the Threshold Questions of Law [Docket No. 164], filed by Bank of America, N.A., as administrative agent for the Debtors' pre-petition lenders (the "Banks"); J. Aron & Company's Consolidated

Motion for Summary Judgment [Docket No. 152], filed by J. Aron & Company ("J.Aron"), an intervening party; and various joinders thereto as reflected on the docket in this adversary proceeding.

For the following reasons, the Court will grant in part the Motion of the Banks and deny the Motion of the Kansas Producers.

I. *PRELIMINARY STATEMENT*

The key question before the Court in this declaratory judgment action is whether a security interest perfected only in Kansas by virtue of the automatic perfection in K.S.A. § 84–9–339(a) is subordinate to a security interest that was duly perfected against the Debtors in this case in accordance with Article 9's rules regarding perfection. For the following reasons, the Court finds that, as a matter of law, such an automatically perfected security interest will be the junior security interest. Accordingly, summary judgment will be entered in favor of the Banks.

The Court recognizes that it is ruling today on issues of great significance to the parties both in economic terms and as a business reality. There is little doubt that this ruling will be appealed. In light of these considerations, the Court will certify this Opinion and Order pursuant to 28 U.S.C. § 158(d)(2)(A)(i) and (iii) for direct appeal to the United States Court of Appeals for the Third Circuit.

II. *BACKGROUND*

A. *General Background*

On July 22, 2008 (the "Petition Date"), SemGroup, L.P. ("SemGroup"), and certain direct and indirect subsidiaries (collectively referred to hereinafter as the "Debtors") each filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code (the "Code"). Included among these entities are three companies that allegedly purchased oil and/or gas (the "Kansas Product") from the Kansas Producers: SemCrude, a limited partnership organized *89 under the law of Delaware (Silverstein Aff., Ex. 6); Eaglwing, a limited partnership organized under the law of Oklahoma (*Id.* at Ex. 8); and SemGas, a limited partnership organized under the law of Oklahoma (*Id.* at Ex. 7). The Debtors' Chapter 11 cases have been consolidated for procedural purposes only and are being jointly administered pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure. The Debtors are authorized to continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Code.

On August 5, 2008, the Office of the United States Trustee (the "U.S. Trustee") appointed an Official Committee of Unsecured Creditors (the "Creditors Committee"). By Order dated October 15, 2008, the Court directed the U.S. Trustee to appoint and constitute a committee to represent the interests of producers of oil and gas who sold product to the Debtors (the "Producers Committee")[Case No. 08–11525, Docket No. 1774]. Both the Creditors Committee and the Producers Committee have retained professionals and have actively participated in these cases.[2]

Founded in February 2000, the Debtors engage in a number of different businesses, each related to the energy industry. Included among the Debtors are several corporations which engage in the business of purchasing various forms of energy products, such as crude oil and natural gas, from producers and then subsequently reselling these products to refiners and other resellers in various types of sale and exchange transactions. Prior to the Petition Date, SemCrude, Eaglwing and SemGas, together with other Debtors, maintained a centralized cash management system in accounts at the Bank of Oklahoma. Cash collections by the Debtors were deposited into these accounts (Eaglwing, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1927]; SemCrude, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1926]; SemGas, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1936]).[3] The consolidated revenues of the Debtors during fiscal year 2007 were approximately $13.2 billion.

Historically, as part of their overall business strategy, the Debtors sought to establish a margin on their anticipated purchases of energy products by selling energy products for physical delivery to customers or by entering into future delivery obligations under futures contracts on the New York Mercantile Exchange ("NYMEX") and over-the-counter ("OTC") markets. In the weeks leading up to the Petition Date, volatile energy prices increased the Debtors' margin requirements, causing a negative impact on the Debtors' liquidity positions. These cash flow problems were further exacerbated by catastrophic trading losses. On July 16, 2008, the Debtors transferred their NYMEX trading account to Barclays Bank PLC, an action that converted loss contingencies into recognized losses that exceeded $2.4 billion. These trading losses and

increased margin requirements eventually prevented the Debtors from ***90** meeting their margin calls, and prompted their Chapter 11 filings.[4]

As of the Petition Date, the Banks asserted secured claims against the Debtors and their affiliates (as either borrowers or guarantors) in the aggregate amount of approximately $2.55 billion. Pursuant to their Amended and Restated Security Agreement, the Banks assert duly perfected security interests in substantially all of the Debtors property.[5]

B. *Factual Background Regarding the Oil and Gas Industry in Kansas*

The parties to this litigation have expended significant time and effort in educating the Court as to the history and particulars of oil and gas ownership and production in Kansas.[6] While the Court is ruling herein on a discrete question of law—the priority between competing security interests—it is both helpful and necessary to review this background in order to place this dispute in a proper framework.

[1] Mineral rights may be severed from the fee simple absolute ownership of property and thus owned separately from the surface interest. (Ks. Pls. Br., Ex. B at Ex. A, ¶ 10). Before extraction, oil and gas are treated as real property; but upon extraction, minerals become "goods." K.S.A. § 84-2a-103(1)-h. The term "as-extracted collateral" thus refers to oil, gas or other minerals that are subject to a security interest before extraction from the ground. (See Del.Code tit. 6, § 9-301; Kan. Stat. Ann. § 84-9-102(a)(6)).

Mineral owners rarely develop their minerals themselves. The technology and business of oil and gas exploration and development is complicated and expensive; few mineral owners possess the expertise or capital they need to act on their own. (Ks. Pls. Br., Ex. B at Ex. A ¶ 11).

Mineral owners typically transfer their mineral rights to an oil company through an oil and gas lease. A fee simple owner or severed mineral owner who grants a lease is called a lessor. A lessor typically receives a cash payment for granting the lease and retains a royalty, a percentage share of the oil and gas produced, or a percentage share of the value or revenues of production free of the costs of production. (*Id.* ¶ 13).

The person or oil company that receives a lease grant is called a lessee, and holds thereby the working interest, which includes the right to search, drill for, develop, produce, and market from the leased land. Often, a lessee will spread the cost of acquiring, evaluating, and exploring a lease by selling undivided percentages of ***91** the working interest to investors. The owners of the working interest have the right to all of the oil and gas they produce from the land, other than that which goes to royalty owners, but must pay all costs of production. (*Id.*).

Both mineral owners and lessees often create from their interests additional types of interests in favor of other parties. These interests include "nonparticipating royalty" interests; "overriding royalty" interests and "carried" interests. (*Id.* ¶ 14).

Operators/working interest owners must obtain permission to drill from certain state agencies that are charged with optimizing production of oil and gas. They require drilling permits from the appropriate agency, and must comply with spacing rules designed to keep wells far enough apart to minimize the amount of drainage from one tract to another. Typically, it is necessary to put together several leases to have enough acreage to form a spacing unit. In addition, after wells have produced to the point that their production levels begin to decline, wells in several spacing units may be unitized, either voluntarily by their lessees, or by order of a state conversion agency, to maximize production from the formation. Unitization refers to the joint operation of all the leases and spacing units over a producing formation, usually in conjunction with enhanced-production techniques, which may substantially increase the percentage of oil and gas that is ultimately recovered. (*Id.* ¶ 16).

The lease owners in a spacing unit select one of their number to act as the unit operator. An operator is responsible for day-to-day operation of the leases within a spacing unit. To facilitate decision-making, the operator and the other working-interest owners in a spacing unit enter into an operating agreement. An operating agreement sets out the parties' agreement with respect to the appointment of the operator, the operators' rights and duties, initial drilling, further development, the sharing of operations costs and revenues, the marketing and sale of oil and gas, and accounting. (*Id.* ¶ 17). As a practical matter, an operating agreement is designed to set forth a process by which the well is drilled and the production is established, and to govern the operations of a productive well after it has been established. An operating agreement combines or pools the leases and fractional interests of the parties for operating purposes so that many leases are operated as if they were one. (Ks. Pls. Br., Ex. B at Ex. A ¶ 17).

Oil produced from a well by the operator is either temporarily placed in storage tanks and then transported

by truck, or placed into a gathering line with other product to be delivered to a pipeline and transported. Natural gas is always directed from the well through gathering lines into a pipeline. Transfer of title for either oil or gas may take place at a point of transfer on the spacing unit or at a market center or hub or at any place in between. (*Id.* ¶ 20).

Typically, royalty owners do not take their oil and gas in kind; royalty owners either sell to the operator or the operator markets their shares. The operators usually act on behalf of the interest owners and sell for the account of the other owners of legal interests in the oil and gas. For example, Kansas production was sold typically to Debtors by the operators of the Kansas wells, as the party authorized to market and sell the production from the Kansas wells. (Ks.Pls.Br.¶¶ 11–12). Less frequently, purchasers contract directly with the owners of the oil and gas, but require that the unit operator accept payment on behalf of all the sellers in the unit and disburse the proceeds. In either case, ***92** the purchaser of oil and gas usually pays the proceeds of sales to the unit operator, who in turn distributes the proceeds to the interest owner. (Ks. Pls. Br., Ex. B at Ex. A ¶¶ 22–23).

Those who disburse proceeds of oil and gas sales use division orders to protect themselves against claims that they have improperly paid to interest owners. A division order is a statement executed by all parties who claim a legal interest in the oil and gas and in the funds generated by its sale, agreeing how the proceeds of oil and gas sales are to be distributed to them. Interest owners who sign division orders and receive payments consistent with the division orders cannot later complain that they were not paid properly. (*Id.* ¶ 24).

In practice, as a result of severance of the mineral estate from the surface estate and partial sales of the minerals, it is not uncommon to find hundreds of royalty owners with interests in a single well. Thus, the task—typically reserved to operators—of distributing proceeds to royalty owners is complex.

The industry custom is that purchasers of oil and gas pay amounts due to the owners on the 20th day of the month following the delivery of oil and on the 25th day of the month following delivery of gas. (Ks. Pls. Br., Ex. B at Ex. A ¶ 25).

C. *Producer Claims*

In the course of their business, several of the Debtors (specifically, SemCrude, SemGas and Eaglwing) entered into agreements with a large number of oil and gas producers located in at least eight different states (collectively referred to hereinafter as the "Oil and Gas Producers") to purchase oil and gas. The Kansas Producers, a subgroup of the oil and gas producers, are generally owners of working interests in oil and gas production from various wells located throughout Kansas, and many are operators of numerous wells pursuant to operating agreements with interest owners. As operators, the Kansas Producers are authorized to market and sell oil and gas from the wells they operate, attributable to and for the benefit of their own working interests and for the benefit of non-operating interest owners and royalty interest owners. In addition, some of the Kansas Producers own non-operating interests in numerous wells that are operated by other parties who sold production to the Debtors.

During the relevant period (from June 1 through July 21, 2008), the Kansas Producers produced oil and gas from hundreds of wells situated in Kansas that was purchased by the Debtors. As noted previously, under general terms between the parties, the Debtors were obligated to pay for the Kansas Producers' production on July 20 and July 25, 2008, for June oil and gas sales, and on August 20 and 25, 2008, for July oil and gas sales.

Historically, the amounts owed on these contracts had been paid by the Debtors without incident in accordance with the above payment schedule. The Debtors' liquidity crisis and bankruptcy filings in the summer of 2008, however, changed this pattern. When the Debtors filed their Chapter 11 petitions on July 22, 2008, the Oil and Gas Producers, including the Kansas Producers, had yet to receive payment for the oil and gas they had sold to the Debtors between June 1, 2008 and the Petition Date.

The failure to pay the amounts owed on these contracts left over a thousand Oil and Gas Producers, including many in Kansas, looking for payment and seeking to determine in this Court what rights, if any, they had in the oil and gas they had sold to the Debtors (or the proceeds from ***93** the Debtors' sale of such product) between June 1 and the Petition Date under the laws of their respective states. Within the month following the Petition Date alone, hundreds of reclamation demands were made upon the Debtors. Many separate adversary proceedings relating to these reclamation demands or purported liens on the oil and gas in question were commenced. A number of emergency motions, seeking either injunctive relief to prevent the sale or disposition of the oil and gas in question or a lifting of the automatic stay to proceed against it, also were filed in this Court within weeks of the Petition Date.

D. *Producer Claims Procedures Orders*

In an attempt to prevent a multiplicity of actions and preserve the resources of the Debtors and the Court, the Debtors filed a motion for authorization to establish omnibus procedures for, *inter alia,* the resolution of the rights and priorities of the Oil and Gas Producers' claims pursuant to sections 105(a) and 362 of the Code and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure [Case No. 08–11525, Docket No. 600]. Following the filing of this motion, representatives of certain Oil and Gas Producers met with representatives of the Debtors to discuss the procedures that could be utilized in such a structure. Through these extensive negotiations, the Debtors and the Oil and Gas Producers reached agreement on a set of procedures that could be used to resolve these issues, and presented this structure to the Court for approval on September 17, 2008. The Court has entered two orders (the "Producer Claims Procedures Orders") adopting this proposed structure [Case No. 08–11525, Docket Nos. 1425; 1557].

The structure approved by the Court calls for the Oil and Gas Producers to initiate one adversary proceeding against the Debtors for each state in which the Oil and Gas Producers sold oil or gas to the Debtors, a total of eight states. The purpose of these adversary proceedings is for the Oil and Gas Producers to obtain a declaratory judgment establishing (i) what rights, if any, are afforded by each respective state's law to a producer of oil or natural gas who sells oil or natural gas to a first purchaser, such as the Debtors here, and (ii) the priority of these rights relative to the Banks' asserted security interests in the Debtors' existing and after-acquired inventory. All of the Oil and Gas Producers were free to participate in this litigation, and the Producer Claims Procedures Orders expressly provided that the results of the litigation would be binding upon the Oil and Gas Producers irrespective of whether they actually participated in this process.

As may be apparent from the foregoing description, the claims of the Kansas Producers involve many individual transactions. Accordingly, the actual calculation and allowance of individual Kansas Producers' claims is not presently before the Court. Likewise, the determination of the extent, validity and priority of the Banks' security interests is not presently before the Court (but is reserved for further proceedings), such that for purposes of this Opinion, the Court and the parties are presuming the validity and perfection of these asserted security interests.

In the present case, the Court will determine the rights, status, and relative priority of the interests of the Kansas Producers in the crude oil and natural gas they sold to the Debtors between June 1, 2008 and July 22, 2008 and the proceeds thereof.

This matter has been fully briefed. The Court has conducted two full days of oral argument on these and related motions in May, 2009. It is ripe for decision.

*94 II. *JURISDICTION AND VENUE*

The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157(a) and (b)(1). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409. Consideration of this adversary proceeding constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B), (K), and (O).

III. *STANDARD OF REVIEW*

The parties have filed cross-motions for summary judgment on the Kansas Producers' claim for declaratory relief. The Court notes that "the standards under which to grant or deny summary judgment do not change because cross-motions are filed." *In re U.S. Wireless Corp., Inc.,* 386 B.R. 556, 560 (Bankr.D.Del.2008).

Summary judgment is only appropriate "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c); Fed. R. Bankr.P. 7056. In doing so, the Court must view all facts and any reasonable inferences that might be drawn from them in the light most favorable to the nonmoving party. *In re Elrod Holdings Corp.,* 394 B.R. 760, 763 (Bankr.D.Del.2008).

In order to avoid summary judgment, the nonmoving party must come forward with specific facts showing that there is a genuine issue for trial. *U.S. Wireless,* 386 B.R. at 559. An issue of material fact is genuine if the factfinder could return a judgment for the nonmoving party on the disputed issue. *Elrod Holdings,* 394 B.R. at 763. If the nonmoving party fails to present facts establishing a genuine issue for trial, the moving party is entitled to summary judgment. Thus, the Court must ask: "(1) is there no genuine issue of material fact and (2) is one party entitled to judgment as a matter of law?" *Gray v. York Newspapers, Inc.,* 957 F.2d 1070, 1078 (3rd Cir.1992) (quoting *Country Floors, Inc. v. Gepner,* 930

F.2d 1056, 1060 (3d Cir.1991)).

[2] In this case, the underlying claim on which both sides seek summary judgment is one for declaratory relief. It is well-settled that declaratory relief is available "to settle actual controversies before they ripen into violations of a law or a breach of duty." *United States v. Fisher–Otis Co.*, 496 F.2d 1146, 1151 (10th Cir.1974); *see Step–Saver Data Sys., Inc. v. Wyse Tech.*, 912 F.2d 643, 647 (3d Cir.1990). Such relief is appropriate where "there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality." *Armstrong World Indus., Inc. by Wolfson v. Adams*, 961 F.2d 405, 411 (3d Cir.1992) (quoting *Md. Cas. Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273, 61 S.Ct. 510, 85 L.Ed. 826 (1941)).

IV. *DISCUSSION*

Presently before the Court are cross-motions for summary judgment on a complaint seeking declaratory relief. As detailed at length below, the parties dispute not only which state law or laws govern this dispute, but also the application of those respective laws.

A. *The Parties' Positions*

The Kansas Producers assert in their motion for summary judgment that, pursuant to Kansas § 9–339a, they are the holders of perfected, purchase money security interests ("PMSIs") in all Kansas Product sold to the Debtors and any resulting proceeds held by the Debtors. As such, the Kansas Producers argue that their rights are prior to the Banks' security interest.[7]

***95** The Banks contend that perfection of the security interests claimed by the Kansas Producers pursuant to Kansas § 9–339a are governed by either Delaware or Oklahoma law, depending upon the relevant Debtor and its place of incorporation pursuant to the choice of law provisions in Article 9 of the UCC. These provisions were adopted uniformly by each state (including Kansas) at issue in this adversary proceeding. To the extent that the Kansas Producers did not perfect their Kansas § 9–339a security interests in either Oklahoma or Delaware before the Petition Date, the Banks contend that the Kansas Producers possess unperfected security interests subordinate to the security interest of the Banks.

The Banks also make two arguments in the alternative. First, they argue that Kansas § 9–339a only provides for perfecting a security interest in "as-extracted collateral," and that none of the collateral at issue in this case fits the Kansas UCC's definition of "as-extracted collateral." Accordingly, the Banks contend, the Kansas Producers have unperfected security interests even if Kansas law were to govern perfection. Second, the Banks assert that even if Kansas law governs and provides the Kansas Producers with perfected security interests, Kansas law limits the Kansas Producers' special PMSI priority arising pursuant to Kansas § 9–339(a) to (i) the remaining oil and gas inventory of the Debtors as of July 22, 2008, the day the Debtors filed bankruptcy, and (ii) any proceeds from the sale of such oil and gas that the Debtors received on or before delivery of the Kansas Product. The relative priority of any security interests not falling into either of these two categories, the Banks argue, is instead governed by the "first to file or perfect" rule found in Kansas § 9–322.

B. *Analysis*

The Court finds summary judgment appropriate in this case because the parties are seeking declaratory relief regarding purely legal questions. Consequently, as described at length below, there is no genuine issue of material fact that precludes the granting of summary judgment.

In addressing the dispute before it, the Court is faced as a threshold matter with choice of law questions involving security interests. Given the uniformity found in most states' versions of Article 9 of the UCC, choice of law issues regarding security interests are rarely litigated. Because Kansas § 9–339a is a non-uniform amendment to Kansas' version of the UCC, however, the Court's resolution of the instant summary judgment motions will differ significantly based on what state law(s) govern perfection of the Kansas Producers' purported security interests, as well as what state law(s) govern the effect of that perfection or nonperfection, and the priority among multiple perfected security interests. An overview of each relevant states' respective law follows.

1. Kansas law

[3] As a preliminary matter, the Court notes that there is no case law, state or ***96** federal, construing Kansas § 9–339a. As such, in interpreting the statute the Court is obliged to predict state law. *See generally Packard v. Provident Nat. Bank*, 994 F.2d 1039, 1049 (3d Cir.1993) (discussing the role of a federal court when predicting state law). When a federal court sets out to predict state law, it sits, in effect, as a state supreme court.

Commissioner v. Estate of Bosch, 387 U.S. 456, 465, 87 S.Ct. 1776, 1783, 18 L.Ed.2d 886 (1967). Any relevant decisions of that state's own lower courts must therefore be researched thoroughly and given great weight, at least in the absence of convincing evidence showing that the state supreme court would not follow them. *See Fidelity Union Trust Co. v. Field*, 311 U.S. 169, 177–78, 61 S.Ct. 176, 178, 85 L.Ed. 109 (1940).

[4] [5] [6] [7] [8] In so doing, this Court employs Kansas' rules of statutory construction. When Kansas courts are called upon to interpret statutes, "the fundamental rule governing that interpretation is that 'the intent of the legislature governs if that intent can be ascertained. The legislature is presumed to have expressed its intent through the language of the statutory scheme it enacted.' " *In re Adoption of G.L.V. and M.J.V.*, 286 Kan. 1034, 190 P.3d 245, 251–52 (2008) (quoting *State ex rel. Stovall v. Meneley*, 271 Kan. 355, 22 P.3d 124, 143 (2001)). It is for this reason that, "when the language of a statute is plain and unambiguous, courts 'need not resort to statutory construction.' " *Id.* (quoting *In re K.M.H.*, 285 Kan. 53, 169 P.3d 1025, 1042 (2007)). That is, " '[w]hen the language is plain and unambiguous, an appellate court is bound to implement the expressed intent.' " *Id.* (quoting *State v. Manbeck*, 277 Kan. 224, 83 P.3d 190 (2004)). But if " 'the face of the statute leaves its construction uncertain, the court may look to the historical background of the enactment, the circumstances attending its passage, the purpose to be accomplished, and the effect the statute may have under the various constructions suggested. [Citation omitted.]' " *Id.* (quoting *Robinett v. The Haskell Co.*, 270 Kan. 95, 12 P.3d 411, 416 (2000)).

[9] [10] [11] Additionally, Kansas courts should generally "construe statutes to avoid unreasonable results and should presume that the legislature does not intend to enact useless or meaningless legislation." *Id.* (quoting *Hawley v. Kansas Dept. of Agriculture*, 281 Kan. 603, 132 P.3d 870, 889 (2006)). Kansas courts must determine the legislature's intent behind particular statutory language " 'from a general consideration of the entire act. Effect must be given, if possible, to the entire act and every part thereof. To this end, it is the duty of the court, as far as practicable, to reconcile the different provisions so as to make them consistent, harmonious, and sensible. [Citation omitted.]' " *Id.* (quoting *In re Marriage of Ross*, 245 Kan. 591, 783 P.2d 331, 334 (1989)). Moreover, if a general and specific statute cannot be construed in harmony, the specific statute will control unless it is clear that the legislature wanted the general statute to control. *State ex rel. Tomasic v. Unified Gov't of Wyandotte County/Kansas City*, 264 Kan. 293, 955 P.2d 1136, 1152 (1998).

a. *Perfection and covered collateral*

As noted above, the Kansas Legislature enacted Kansas § 9–339a as a non-uniform amendment to Kansas' version of the Uniform Commercial Code. Subsection (a) of Kansas § 9–339a provides for the creation of a security interest in favor of "interest owners":

> This section provides a security interest in favor of interest owners (as secured parties) to secure the obligations of the first purchaser of oil and gas production ***97** (as debtor) to pay the purchase price. A signed writing giving the interest owner a right under real estate law operates as a security agreement created under article 9 of chapter 84 of the Kansas Statutes Annotated, and amendments thereto. The act of the first purchaser in signing an agreement to purchase oil or gas production, in issuing a division order, or in making any other voluntary communication to the interest owner or any governmental agency recognizing the interest owner's right operates as an authentication and adoption of the security agreement in accordance with K.S.A. 84–1–201(39), and amendments thereto.

K.S.A. § 84–9–339a (a).

The term "interest owner" is defined as "a person owning an entire or fractional interest of any kind or nature in oil or gas production at the time of severance, or a person who has an express, implied or constructive right to receive a monetary payment determined by the value of oil or gas production or by the amount of production." *Id.* at § 9–339a(p)(2). A "first purchaser," meanwhile, is defined as "the first person that purchases oil or gas production from an operator or interest owner after the production is severed, or an operator that received production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement signed by the operator under which the operator collects proceeds of production on behalf of other interest owners." *Id.* at § 9–339a(p)(3).[8] An "operator" is "a person engaged in the business of

severing oil and or gas production from the ground, whether for the operator alone, for other persons alone or for the operator and others." *Id.* at § 9–339a(p)(4).

As noted above, the statute treats an agreement to purchase oil or gas production, the issuance of a division order, and "any other voluntary communication" from the operator or first purchaser to the interest owner or any governmental agency recognizing the interest owner's rights as the authentication and adoption of a security agreement. *Id.* at § 9–339a(a). Unlike in some states with similar statutes, however, this security interest is not automatically perfected in Kansas. Instead, § 9–339a(b) provides that:

> In order for any interest owner to claim the security interest provided by this section, an affidavit of production must be filed as prescribed by K.S.A. 55–205, and amendments thereto, which affidavit must show that a well or wells capable of producing in paying quantities have been completed on the pertinent oil and gas lease or leases and lands covered thereby. This filing is effective as a financing statement covering as-extracted ***98** collateral as provided by K.S.A. 84–9–501, and amendments thereto, and the security interest provided by this section is perfected as of the date of recording. There is no requirement of refiling every five years to maintain the effectiveness of the filing.

Id. at § 9–339a (b).

[12] Thus, a perfected security interest arising under Kansas § 9–339a does not require an actual written security agreement or the filing of an actual financing statement. Instead, the security interest arises upon either (i) an agreement to purchase oil or gas production, (ii) the issuance of a division order, or (iii) "any other voluntary communication" that meets the requirements set forth above, and is perfected upon the filing of an affidavit of production or its equivalent.

The security interests created by Kansas § 9–339a encumber: (i) oil and gas production in the possession of the first purchaser, and (ii) proceeds thereof received by or due to the first purchaser. *Id.* at § 9–339a(c). These security interests exist "for an unlimited time" if:

> (A) The proceeds are oil or gas production, inventory of raw, refined or manufactured oil or gas production, or rights to or products of any of these, although the sale of such proceeds by a first purchaser to a buyer in the ordinary course of business as provided in subsection (e) will cut off the security interest in those proceeds;
>
> (B) the proceeds are accounts, chattel paper, instruments and documents; or
>
> (C) the proceeds are cash proceeds.

Id. at § 9–339a (c)(1)(A), (B), and (C).

Section 9–102(a)(9) defines "cash proceeds" as "proceeds that are money, checks, deposit accounts, or the like." *Id.* at § 9–102(a)(9). Otherwise the security interest exists "for the length of time provided by K.S.A. 84–9–315, and amendments thereto, as to all other proceeds." *Id.* at § 9–339a(c)(2). Kansas § 9–339a recognizes the historic practice of allowing full payment from a buyer in the ordinary course to ultimately discharge the interest owner's security interest, however. *See id.* at § 9–339a (e).

Moreover, Kansas § 9–339a(j) provides that a security interest created by the statute "remains effective against the debtor and perfected against the debtor's creditors even if assigned, regardless of whether the assignment is perfected against the assignor's creditors. If a deed, mineral deed, assignment of oil or gas lease, or other such writing evidencing the assignment is filed in the real estate records of the county, it will have the same effect as filing an amended financing statement under K.S.A. 84–9–515, and amendments thereto." *Id.* at § 9–339a (j).

In addition to, and not to be confused with the interest owners' security interests in oil and gas and resulting proceeds, Kansas § 9–339a provides for the creation of a statutory lien that "secures the payment of all taxes that are or should be withheld or paid by the first purchaser, and a lien that secures the rights of any person who would be entitled to a security interest under subsection (c)(1)(A) of this section except for lack of any adoption of a security agreement by the first purchaser or a lack of possession or writing required by K.S.A. 84–9–201 or 84–9–203, and amendments thereto, for the security interest to be enforceable." *Id.* at § 9–339a(d).[9]

[13] As noted briefly above, the Banks argue that Kansas § 9–339a(b)'s language ***99** stating that the filing of an affidavit of production is required to perfect the security

interests asserted by the Kansas Producers, and that such a filing "is effective as a financing statement covering as-extracted collateral as provided by K.S.A. 84–9–501" indicates that Kansas § 9–339a only provides a security interest in as-extracted collateral. This argument is significant, because both sides acknowledge that Kansas' definition of "as-extracted collateral" would exclude the Kansas Producers. K.S.A. § 84–9–102(a)(6) defines "as-extracted collateral" as:

> (A) Oil, gas, or other minerals that are subject to a security interest that:
>
> (i) Is created by a debtor having an interest in the minerals before extraction; and
>
> (ii) attaches to the minerals as extracted; or
>
> (B) accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.

Id. at § 9–102(a)(6).

The Kansas Producers, meanwhile, argue that the phrase "effective as a financing statement covering as-extracted collateral" means that the filing of an affidavit of production gives a party the same rights they would have if they filed a financing statement covering "as-extracted collateral" under Kansas law.

This Court believes that, were it to consider the issue, the Kansas Supreme Court would embrace the Kansas Producers' reading on this point, based on the plain language of the statute. In so holding, the Court finds that the language of Kansas § 9–339a(b) cannot be read as limiting the security interests provided by Kansas § 9–339a to security interests arising in as-extracted collateral. Moreover, the structure of Kansas § 9–339a counsels against the reading espoused by the Banks as well. Subsection (b), in which the disputed language appears, is the subsection governing perfection. Were the Bank's reading correct, such language would most likely be found in subsection (a) or (c), each of which address the scope of the security interest created by Kansas § 9–339a.

b. *Priority*

[14] Subsection (f)(1) of Kansas § 9–339a provides that "[s]ecurity interests created by this section shall be treated as purchase money security interests for purposes of determining their relative priority under K.S.A. 84–9–322, 84–9–323 or 84–9–324, and amendments thereto; holders of these security interests are not required to give the written notices as provided by K.S.A. 84–9–324, and amendments thereto, to enjoy purchase money priority over security interests with a prior financing statement covering inventory." *Id.* at § 9–339a(f)(1). Sections 9–322 and 9–323 are the Kansas UCC's general priority and future advances sections, respectively. The last section referred to, Kansas § 9–324, is the Kansas UCC's section governing priority of purchase money security interests.

Of particular importance to the instant dispute are the provisions of Kansas § 9–324(a) and (b):

> (a) Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in K.S.A. 84–9–327 and amendments thereto, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor ***100** receives possession of the collateral or within 20 days thereafter.
>
> (b) Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in K.S.A. 84–9–330 and amendments thereto, and, except as otherwise provided in K.S.A. 84–9–327 and amendments thereto, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:
>
> (1) the purchase-money security interest is perfected when the debtor receives possession of the inventory;
>
> (2) except where excused by K.S.A. 84–9–340, and amendments thereto, the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
>
> (3) the holder of the conflicting security interest receives any required notification within five years before the debtor receives possession of the inventory; and
>
> (4) the notification states that the person sending

> the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

Id. at § 9–324(a), (b).

The parties vigorously dispute just how Kansas § 9–339(f)(1) interacts with Kansas § 9–324, § 9–324(b). The parties all acknowledge that Kansas § 9–339a(*o*) provides that "[t]he rights of any person claiming under a security interest or lien created by this section are governed by the other provisions of [Article 9] except to the extent that this section necessarily displaces those provisions." But the parties disagree regarding the question of whether Kansas § 9–339a, including but not limited to subsection (f)(1), necessarily displaces Kansas § 9–324. The Kansas Producers argue that it does. The Banks argue that it does not.

The Banks contend that Kansas § 9–339a(f)(1)'s language dictating that the security interests created by Kansas § 9–339a(a) "shall be treated as purchase money security interests for purposes of determining their relative priority under K.S.A. 84–9–322, 84–9–323 or 84–9–324, and amendments thereto" means just what it says. That is, the Banks contend that the PMSI priority created by Kansas § 9–339a(f)(1) is no more or less broad than any other PMSI in inventory would be, and is thus subject to the same cutoff rules as all other PMSIs in inventory. This is the case, they contend, because nothing in any part of Kansas § 9–339a expressly provides otherwise. Consequently, the general rules regarding PMSIs in Kansas § 9–324 are not displaced by Kansas § 9–339a, and, as per Kansas § 9–339a(*o*), the general rules therefore govern the terms of the PMSI created by Kansas § 9–339a (f)(1).

By contrast, the Kansas Producers posit that Kansas § 9–339a was intended to be, and is, a self-contained statutory provision that completely governs the rights of interest owners with respect to the security interests provided therein in oil and gas and resulting proceeds. In support of this argument, the Kansas Producers cite examples of other provisions of Kansas § 9– ***101** 339a—distinct from subsection (f)(1)—contradicting other provisions of Kansas' Article 9.

The Kansas Producers also argue that Kansas § 9–324 is directly displaced by Kansas § 9–339a(c), when read in conjunction with Kansas § 9–339a(a). Kansas § 9–339a(c) provides that the security interest granted to the Kansas Producers by the remainder of Kansas § 9–339a

> exists in oil and gas production, and also in the following proceeds of such production owned by, received by, or due to the first purchaser:
>
> (1) For an unlimited time if:
>
> (A) The proceeds are oil or gas production, inventory of raw, refined or manufactured oil or gas production, or rights to or products of any of these, although the sale of such proceeds by a first purchaser to a buyer in the ordinary course of business as provided in subsection (e) will cut off the security interest in those proceeds;
>
> (B) the proceeds are accounts, chattel paper, instruments and documents; or
> (C) the proceeds are cash proceeds.[10]

Id. at § 9–339a (c)(1).

Finally, the Kansas Producers argue that the operation of the oil and gas industry supports construing those entitled to PMSI priority under the Kansas statute broadly. Put simply, they contend that, as a practical matter, the oil and gas industry works in such a manner that PMSI priority would, under Kansas § 9–324(b), always be limited to inventory still in the hands of a first purchaser (or, in the case of bankruptcy, inventory still in the hands of a first purchaser on the day the bankruptcy petition is filed). The Kansas Legislature, they argue, must have intended for the PMSI priority to extend more broadly.[11]

On this point, the Court believes that the Kansas Supreme Court would adopt the Banks' reading based on the plain language of Kansas § 9–339a. In so doing, the Court holds that the general rules regarding PMSIs in Kansas § 9–324 are not displaced by Kansas § 9–339a and therefore serve to govern Kansas § 9–339a.

To embrace the Kansas Producers' argument that Kansas § 9–339a is a self-contained statutory provision would essentially read Kansas § 9–339a(*o*)'s directive regarding when the section is governed by other Article 9 provisions out of the statute. Moreover, the Kansas Producers' examples where other parts of Kansas § 9–339a, which are unrelated to Kansas § 9–324's language regarding PMSI priority, displace other sections of Kansas' version of Article 9 are irrelevant to the issue of whether Kansas § 9–324 is displaced by Kansas § 9–339a. Displacement of Article 9 by Kansas § 9–339a is not an all-or-nothing proposition; Kansas § 9–339a can displace some sections, but not others.

What is relevant is whether specific language in Kansas § 9–339a necessarily displaces Kansas § 9–324's rules regarding PMSI priority in inventory, and the only language offered by the Kansas Producers is insufficient

to support the proposition. The Kansas Producers essentially argue *102 that when Kansas § 9–339a(a), (b), (c), and (f) are read together, they state that the security interest "provided by this section" shall be "treated as purchase-money security interests" in dealing with other security interests not provided by § 9–339a, and shall continue "[f]or an unlimited time" in most forms of proceeds. Put another way, the Kansas Producers argue that Kansas § 9–339a(c)' s "unlimited time" language necessarily displaces Kansas § 9–324(b)'s limitations on the life of a PMSI in inventory.

The main problem with this reading, however, is that it overlooks exactly what it is that continues for an unlimited time under Kansas § 9–339a(c): the Kansas Producers' security interest, not the Kansas Producers' PMSI priority. Had the Kansas Legislature wanted the Kansas Producers' PMSI to continue for an unlimited time, it could have expressly stated as much, but it did not. Instead, it gave the Kansas Producers a security interest that continues for an unlimited time in most forms of proceeds, and it provided that this security interest is "treated as" a PMSI. To see what type of priority a PMSI enjoys under Kansas law (and to what collateral it attaches), however, the Court must look to Kansas § 9–324, including Kansas § 9–324(b) in the case of inventory. Otherwise, the Court would be at a loss for how to treat the Kansas Producers' security interests as PMSIs.

[15] Thus, the Court holds that, pursuant to Kansas § 9–324(b), the Kansas Producer's PMSI priority is limited to inventory on hand at the time the Debtors filed bankruptcy, any identifiable cash proceeds that the Debtors received prior to delivery of the oil and gas production to the subsequent purchaser, and certain chattel paper. *Id.* at § 9–324(b).

But the Kansas Producers who meet the requirements set forth in Kansas § 9–339a could still be granted a security interest if Kansas law governs perfection in this adversary proceeding, even if they do not qualify for PMSI priority, and these security interests could prove quite valuable. As noted above, subsection (a) of Kansas § 9–339a provides for the creation of a security interest in favor of interest owners and provides that "[a] signed writing giving the interest owner a right under real estate law operates as a security agreement created under [Article 9]." K.S.A. § 84–9–339a(a). Subsection (b) of Kansas § 9–339a, meanwhile, provides for perfection of this security interest by the filing of an affidavit of production and, more importantly, dictates that such a filing "is effective as a financing statement covering as-extracted collateral as provided by K.S.A. 84–9–501, and amendments thereto, and the security interest provided by this section is perfected as of the date of recording. There is no requirement of refiling every five years to maintain the effectiveness of the filing." *Id.* at § 9–339a(b). Moreover, Kansas § 9–339a provides that a security interest (or statutory lien) created by the statute "remains effective against the debtor and perfected against the debtor's creditors even if assigned, regardless of whether the assignment is perfected against the assignor's creditors." *Id.* at § 9–339a(j). If a deed, mineral deed, assignment of oil or gas lease, or other such writing evidencing the assignment is filed in the real estate records of the county, it will have the same effect as filing an amended financing statement under K.S.A. 84–9–515, and amendments thereto. *Id.*

Section § 9–322 of Kansas' version of Article 9 provides that "conflicting perfected security interests ... rank according to priority in time of filing or perfection. Priority dates from the earlier of the time of a filing covering the collateral is first *103 made or the security interest ... is first perfected." *Id.* at § 9–322(a)(1). For purposes of subsection (a)(1), "[t]he time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds." *Id.* at § 9–322(b)(1).

In practice, any given Kansas Producer may have filed an affidavit of production in the applicable county clerk's office before the Banks' financing statement was filed. Accordingly, under the "first to file or perfect" rule, the Kansas Producers' security interests in collateral such as oil and gas production, accounts, cash, exchanged oil and gas, and the like, which extend for an unlimited time pursuant to § 9–339a(c), would take priority under Kansas law over the Banks' competing Article 9 security interest in the same collateral to the extent that such affidavits of production benefiting the Kansas Producers were filed prior to the Banks' financing statements covering the same collateral.

[16] To the extent that creditors possess unperfected security interests, however, they will be subordinate to a perfected security interest in the same collateral under Kansas' Article 9 priority rules. This is because Kansas § 9–322(a)(2) provides that "[a] perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien."

2. Delaware law

Delaware's version of Article 9 applies to, *inter alia,* "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract." 6

Del. C. § 9–109. In this regard, the scope of Delaware's Article 9 is identical to Kansas § 9–109, and 12A Okl. St. Ann. § 1–9–109.

As noted above, Kansas § 9–339a is a non-uniform amendment to Kansas' version of Article 9 of the UCC. Delaware's version of Article 9 does not contain a similar provision providing for automatic perfection of a security interest to producers of oil and gas. Instead, oil and gas producers seeking to perfect a security interest under Delaware law are left to do so via Article 9's traditional methods of perfection. These include filing a financing statement, taking possession of the collateral, and, when appropriate, obtaining "control" over the collateral.

[17] To the extent that Delaware law governs perfection and certain creditors, such as the Kansas Producers, fail to perfect security interests in Delaware before the relevant debtor files bankruptcy, these creditors will be subordinate to a creditor who has a perfected security interest in the collateral in question under Delaware's Article 9 priority rules. *See id.* at § 9–322(a)(2).

3. Oklahoma law

[18] Like Delaware's version of Article 9, Oklahoma's UCC does not contain a provision similar to Kansas § 9–339a.[12] Thus, producers of oil and gas who wish to perfect an Article 9 security interest under Oklahoma law must either file a financing statement in Oklahoma, take possession of the collateral in question, where allowed, or obtain control over the collateral in question, again where allowed, in order to do so. To the extent producers fail to properly perfect their security interest via one of these methods, any security interest ***104** they possess will be unperfected under Oklahoma law. Just as in Delaware and Kansas, an unperfected security interest will be subordinate to a perfected security interest under Oklahoma's Article 9 priority rules. *See* 12A Okl.St.Ann. § 1–9–322.

4. Choice of law

The issues before this Court with respect to the claims of the Kansas Producers are: (i) whether, under applicable choice of law principles, Kansas law governs the perfection and/or priority of the Kansas Producers' claimed security interests against the Debtors; and (ii) if Kansas law applies and if the Kansas Producers have perfected security interests thereunder, whether and to what extent the Kansas Production and the proceeds thereof have priority over the competing Article 9 security interests of the Banks.

a. *Governing law of perfection*

[19] "When two states have a connection to a case and an issue arises on which the states' respective laws differ, a choice of law must be made." *PHP Liquidating, LLC v. Robbins (In re PHP Healthcare Corp.)*, 128 Fed.Appx. 839, 843 (3d Cir.2005). *See also Huber v. Taylor*, 469 F.3d 67, 74, 76 (3d Cir.2006) (where there is "a true conflict between ... potentially applicable bodies of law" it is necessary "to examine the law of *all* the relevant jurisdictions") (emphasis in original). Here, Kansas § 9–339a is a non-uniform amendment to the UCC, which differs from the standard UCC rules regarding the perfection and priority of security interests. Accordingly, this Court must determine which states' laws govern (i) perfection of the Kansas Producers' alleged security interests in the Kansas Product and the proceeds thereof and (ii) whether the Kansas Producers' claimed security interests in the Debtors' assets have priority over the Bank's conflicting security interest in the same assets. The fact that Kansas enacted non-uniform provisions of the UCC concerning Kansas oil and gas does not end the inquiry as to whether the security interests claimed by the Kansas Producers have priority over the competing security interests of the Banks in assets of the relevant Debtors—a Delaware entity and two Oklahoma entities.

[20] [21] In the absence of a specific federal policy or interest dictating the use of federal choice of law rules, it is well settled in this Circuit that a bankruptcy court faced with the issue of which substantive state law to apply to a claim for relief in an adversary proceeding applies the choice of law rules of the forum state. *PHP Liquidating*, 128 Fed.Appx. at 843 (3d Cir.2005); *Robeson Indus. Corp. v. Hartford Accident & Indemn. Co.*, 178 F.3d 160, 164–65 (3d Cir.1999); *Charan Trading Corp. v. Uni–Marts, LLC (In re Uni–Marts, LLC)*, 399 B.R. 400, 414 n. 4 (Bankr.D.Del.2009); *Pickett v. Integrated Health Servs., Inc. (In re Integrated Health Services, Inc.)*, 304 B.R. 101, 106 (Bankr.D.Del.2004), *aff'd*, 233 Fed.Appx. 115, 118 n. 2 (3d Cir.2007). Because *Klaxon v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941), "make[s] clear that federal law may not be applied to questions which arise in federal court but whose determination is not a matter of federal law," *In re Merritt Dredging Co.*, 839 F.2d 203, 206 (4th Cir.1988), state choice of law rules must be applied in adversary proceedings in bankruptcy court.

[22] The Kansas Producers argue that in deciding the choice of law question here, this Court should not apply Delaware's choice of law rules and should instead assess which state has the "most significant contacts and

relationships." (*See* Ks. Pls. Opp. Br. at 10 (adopting Texas Producers' ***105** choice of law argument); Tex. Pls. Opp. Br. at p. 20). However, while *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946), on which Plaintiffs rely, "contains some broad statements that may be read to suggest that bankruptcy courts should not adopt the choice of law rules of the forum state," the Court did not hold that federal choice of law rules apply to state law claims in adversary proceedings in bankruptcy courts. *Bianco v. Erkins (In re Gaston & Snow)*, 243 F.3d 599, 606–07 (2d Cir.2001). Thus, the holding in *Vanston* does not conflict with the Bank's position here that the forum's choice of law principles apply.

In sum, applicable Third Circuit precedent makes clear that Delaware's choice of law rules regarding perfection and priority of UCC security interests apply to the claims of the Kansas Producers in these adversary proceedings. This Court is not free to disregard Article 9's choice of law rules and engage in its own *ad hoc* assessment of which states have the most significant contacts here.[13]

In resolving choice of law questions, Delaware courts apply the Restatement (Second) of the Law Conflict of Laws ("Restatement"). *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 46–47 (Del.1991); *Oliver B. Cannon & Son, Inc. v. Dorr–Oliver, Inc.*, 394 A.2d 1160, 1166 (Del.1978). Under the Restatement, a court "will follow a statutory directive of its own state on choice of law." Restatement § 6(1). As the Comment to this Restatement section states, "[t]he court must apply a local statutory provision directed to choice of law provided that it would be constitutional to do so. An example of a statute directed to choice of law is the Uniform Commercial Code which provides in certain instances for ... the application of the law of a particular state." Section 9–301 of the Delaware UCC, Del.Code Ann. tit. 6, § 9–301 (Delaware § 9–301), titled "Law governing perfection and priority of security interests," is precisely such a statutory directive. Delaware § 9–301 governs choice of law determinations with respect to non-uniform amendments to the UCC regarding the perfection and priority of security interests, such as Kansas § 9–339a. Delaware § 9–301 must be applied as written.

[23] There is no merit to the contention of the Kansas Producers that Delaware § 9–301 does not apply here. Citing § 9–109(a)(1) of the Delaware UCC, they have asserted that Delaware's UCC, including § 9–301, is inapplicable because the "purchase money security interests" they claim are created by statute, and thus are statutory liens, not Article 9 UCC security interests that arise "by contract." (*See* Ks. Pls. Opp. Br. at 10)(adopting Texas Producers' choice of law argument).[14]

Kansas § 9–339a makes clear that it creates a security interest that can arise only by contract and that is within the scope of both Kansas' and Delaware's version of Article 9.[15] Plaintiffs rely on subsection (a) ***106** of Kansas § 9–339a, which creates "a security interest in favor of interest owners (as secured parties) to secure the obligations of the first purchaser of oil and gas production (as debtor) to pay the purchase price." But the statute specifically provides that "[a] signed writing giving the interest owner a right under real estate law operates as a security agreement created under article 9 of chapter 84 of the Kansas Statutes Annotated, and amendments thereto." *See* Kansas § 9–339a(a). It also states that:

> [t]he act of the first purchaser in signing an agreement to purchase oil or gas production, in issuing a division order, or in making any other voluntary communication to the interest owner or any governmental agency recognizing the interest owner's right operates as an authentication and adoption of the security agreement in accordance with K.S.A. 84–1–201(39), and amendments thereto.
> *Id.*

When asked to interpret a similar statute, Texas § 9.343, the court in *In re Enron North America Corp.*, 312 B.R. 27 (S.D.N.Y.2004), stated that the Texas law "was designed to 'mirror[ ] the creation of a consensual security interest by deeming that certain standard conveyancing and marketing instruments fulfill the documentation requirements imposed by article 9 [of the UCC].' " *Id.* at 31 (quoting *In re Enron Corp.*, 302 B.R. 455, 459 (Bankr.S.D.N.Y.2003)). Kansas § 9–339a, which was modeled after the Texas statute and tracks its language to a great extent, is structured the same way. Therefore, this Court concludes that the Kansas Producers claim consensual security interests that arise by contract, not statutory liens or similar statutory interests, and considers the choice of law issue in this context.

[24] The Kansas Producers argue that, even if the Delaware UCC were to govern, that it defers to a statute such as Kansas § 9–339a in two separate instances. The first such instance is Delaware § 9–109(c)(3), which provides that Delaware's version of Article 9 does not apply to the extent that "a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit." 6 Del. C. § 9–109(c)(3). It is well-settled, however, that this languages only addresses governmental debtors. *See id.* at

§ 9–109 official cmt. ¶ 9. Thus, it is inapplicable to this case.

[25] The second instance is no more persuasive. The Kansas Producers cite Official Comment 7 to Delaware § 9–320. This Comment states, in the context of a discussion of Delaware § 9–320(d), that:

> Under subsection (d), a buyer in ordinary course of business of minerals at the wellhead or minehead or after extraction takes free of a security interest created by the seller. Specifically, it provides that qualified buyers take free not only of Article 9 security interests but also of interests "arising out of an encumbrance." ... This issue is significant only in a minority of states. Several of them have adopted special statutes and nonuniform amendments to Article 9 to provide special protections ***107** to mineral owners, whose interests often are highly fractionalized in the case of oil and gas. *See* Terry I. Cross, *Oil and Gas Product Liens—Statutory Security Interests for Producers and Royalty Owners Under the Statutes of Kansas, New Mexico, Oklahoma, Texas and Wyoming*, 50 Consumer Fin. L.Q. Rep. 418 (1996). *Inasmuch as a complete resolution of the issue would require the addition of complex provisions to this Article, and there are good reasons to believe that a uniform solution would not be feasible, this Article leaves its resolution to other legislation.*

6 Del. C. § 9–320(d) official cmt. ¶ 7 (emphasis added).

The Kansas Producers argue that the language emphasized above indicates that the Delaware UCC defers to these nonuniform UCC provisions governing oil and gas production. Putting aside the fact that this language is from an Official Comment, and not from statutory text, the Court holds otherwise. Stating that a "uniform solution" to such oil and gas interests "would not be feasible" and is therefore left to "other legislation" does not mean that Delaware law defers to such "other legislation." Rather, this language, which was adopted from model Article 9, merely recognizes that some states will enact non-uniform UCC amendments on the subject governed by Delaware § 9–320(d). The Court's interpretation of Comment 7 is further supported by the fact that the Comment does not accompany one of Delaware's choice of law provisions, but rather a provision governing the extinguishment of security interests in oil and gas by a buyer in the ordinary course.

Application and enforcement of Article 9's choice of law rules here would also further a "primary goal" of the UCC, i.e., " 'to promot[e] certainty and predictability in commercial transactions.' " *Shell Oil v. HRN, Inc.*, 144 S.W.3d 429, 435 (Tex.2004) (quoting *Am. Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86, 92 (Tex.2000)). "One of the principal purposes of the 2001 changes in Article 9 of the UCC was to require that all UCC security interest filings for a given corporation be made in the corporation's state of incorporation." *In re Aura Systems, Inc.*, 347 B.R. 720, 724 (Bankr.C.D.Cal.2006).

Original Article 9 provided that the state where collateral was located was usually the proper location for perfecting a security interest. *See* UCC 9–301 official cmt. ¶ 4. This law was unsatisfactory to the American Law Institute (ALI) and the Uniform Law Commission of The National Conference of Commissioners on Uniform State Laws (NCCUSL), the entities responsible for the drafting of Revised Article 9, for two reasons. *See id.* First, lenders seeking a security interest in a corporation's collateral would have to examine the filings in all states where the corporation had collateral to make sure that there was no outstanding encumbrance in such collateral, and they were required to file financing statements in every state where such collateral was located. *See id.* This process was deemed overly burdensome on commerce, and consequently Revised Article 9 "reduces the number of filing offices in which secured parties must file or search when collateral is located in several jurisdictions." *Id.*

Second, personal property is frequently moved from state to state. Under original Article 9, "a secured creditor could lose its security interest if it did not adequately keep track of the location of its collateral and take appropriate subsequent steps, within an appropriate time frame, to maintain its secured status by filing in the new state or states where the collateral came to rest." *Aura Systems*, 347 B.R. at 724 (citing UCC § 9–103 (1972) (amended effective ***108** July 1, 2001)). "In addition, a secured creditor would have to investigate the provenance of collateral to find out if it was subject to a prior perfected security interest in another state." *Id.*

As has been noted elsewhere, "[t]he goal of the 2001 amendments here at issue was to make a UCC security interest filing permanent and easy to find." *Id.* This is in keeping with the longstanding goal of Article 9 "to create a simple and clear notice filing system." *First Agri Serv., Inc. v. Kahl, et al.*, 129 Wis.2d 464, 385 N.W.2d 191, 196 n. 9 (Ct.App.1986). For an Oklahoma corporation, for instance, a potential creditor now can simply examine the UCC filings in Oklahoma to determine whether there is a financing statement covering any collateral belonging to the corporation anywhere in the United States.[16] Ignoring Article 9's choice of law rules would not only compromise this system and unravel a national, notice-filing system, but also would ignore the enactment of UCC 9–301 by each state legislature that is in any way even remotely involved in this adversary proceeding, including Kansas.

Thus, this Court will apply Delaware § 9–301 to determine which states' substantive laws govern perfection and priority of the security interests claimed by the Kansas Producers. The general rule of Delaware (and Kansas and Oklahoma) § 9–301 is that the location of the debtor governs perfection. Del.Code Ann. tit. 6, § 9–301(1). As Official Comment 4 to Delaware § 9–301 states, "the law governing perfection of security interests ... is the law of the jurisdiction of the debtor's location, as determined under Section 9–307." Section 9–307(e) provides that the location of a registered organization is the state in which the entity was organized. Thus, the locations of SemCrude, Eaglwing and SemGas are Delaware, Oklahoma and Oklahoma, respectively. None of these three Debtors is "located" in Kansas.

[26] [27] Under Delaware § 9–301, the law of the location of the relevant Debtor governs perfection of the Kansas Producers' claimed security interests to the extent that, as of the Petition Date, that Debtor had possession of the oil and gas originating from the Kansas Producers or proceeds thereof in the form of exchanged oil or gas. The law of the location of the relevant Debtor also governs perfection of proceeds of the Kansas Product held in the form of accounts receivable as of the Petition Date. *See id.* at § 9–301 official cmt. ¶ 3, Example 1.

[28] Under Delaware § 9–301, the only relevant exception to the general rule that the law of the location of the Debtor governs perfection is Delaware § 9–304(a). That section provides, with respect to cash proceeds of the Kansas Product held by the Debtors in bank accounts as of the Petition Date, that "[t]he local law of [the] bank's jurisdiction governs perfection." A "bank's jurisdiction for purposes of this" provision means, in general, the law that the bank and the debtor or customer agreed would apply or, if there is no such agreement, the law of the place where the office in which the account is located. *Id.* at § 9–304(b). Schedules filed by the Debtors in these cases show that their cash, as of the Petition Date, was held in a bank located in Oklahoma. (Eaglwing, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1927]; SemCrude, L.P. First Amended Schedules/Statements, Sch. B [***109** Case No. 08–11525, Docket No. 1926]; SemGas, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1936]). Therefore, the perfection of security interests in cash proceeds of Kansas Product is governed by Oklahoma law, not Delaware or Kansas law.[17]

[29] The Court also acknowledges that Delaware § 9–301(4) provides that "[t]he local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral." As noted above, the Kansas Producers who have filed an affidavit of production in Kansas are deemed to have filed a financing statement covering as-extracted collateral. To the extent that this language transforms the Kansas Product into "as-extracted collateral," it does so only under Kansas law. Because the Kansas Product does not fit within Delaware's definition of "as-extracted collateral," however, the rule in Delaware § 9–301(4) is not triggered. That is, the Kansas Product is not considered to be as-extracted collateral under Delaware law, thus the exception for as-extracted collateral in Delaware § 9–301(4) does not apply.

[30] Consequently, Kansas § 9–339a does not govern in deciding whether the Kansas Producers' claimed security interests were perfected. Rather, Delaware law or Oklahoma law govern perfection. Under either Delaware law, Del.Code Ann. tit. 6, § 9–310(a), or Oklahoma law, Okla. Stat. tit. 12A, § 1–9–310(a), the Producers would have had to file UCC financing statements in those states to perfect their security interests in the Kansas Product and the proceeds thereof. Thus, the Court concludes that unless the Kansas Producers can show in Phase II of this litigation that they have properly filed financing statements in Delaware or Oklahoma, as applicable, they do not have perfected security interests in the Kansas Product, or the proceeds thereof.

b. *Governing law of priority*

Assuming, arguendo, that the Kansas Producers properly filed UCC financing statements with respect to the Kansas Product and proceeds thereof prior to the Petition Date, the law governing the priority of the Kansas Producers'

claimed security interests relative to competing Article 9 security interests would also be determined by Delaware § 9–301.

[31] Pursuant to Delaware § 9–301, priority is decided under the law of the Debtor's location unless one of the exceptions enumerated in Delaware § 9–301 applies. Here, as set forth below, the Kansas Producers' alleged security interests in Kansas Product and proceeds thereof in the form of exchanged oil and gas and cash are all exceptions to the general rule. Only the priority of the Kansas Producers' claimed security interest in proceeds of the Kansas Product held by Debtors in the form of accounts receivable as of the Petition Date is determined under the law of the Debtor's location, be it Delaware or Oklahoma.

[32] One applicable exception to the general rule of Delaware § 9–301 is set forth in § 9–301(3)(C), which provides that "while ... goods ... [are] located in a jurisdiction, the local law of that jurisdiction governs ... the priority of a nonpossessory security interest in the collateral." Under this exception, to the extent that the Debtors held, as of the Petition Date, Kansas Product or exchanged oil or gas ***110** proceeds, the law of the state in which the collateral was located as of the Petition Date would determine the priority of the Kansas Producers' claimed security interests.

[33] The other relevant exception concerning priority is Delaware § 9–304, which prescribes the "[l]aw governing perfection and priority of security interests in deposit accounts." Under Delaware § 9–304, because the Debtors' bank accounts were located in Oklahoma, Oklahoma law governs the priority of the Kansas Producers' alleged security interests in cash proceeds held in Oklahoma deposit accounts as of the Petition Date. Under Oklahoma law, "[c]onflicting perfected security interests ... rank according to priority in time of filing or perfection." Okla. Stat. tit. 12A, § 1–9–322(a)(1).

[34] Thus, even if the Kansas Producers had perfected security interests in the Kansas Product and the proceeds thereof, Kansas law would govern only the priority of the Kansas Producers' security interests in Kansas Product or proceeds thereof in the form of exchanged oil or gas held by the Debtors in Kansas as of the Petition Date.

5. Analysis under governing law

Either Delaware or Oklahoma law will govern perfection of the Kansas Producers' security interests provided by K.S.A. § 9–339a. The fact that these security interests may be entitled to perfection under Kansas Law is not dispositive, because Kansas law does not govern perfection of the Kansas Producers' claims against the defendants in this adversary proceeding. In order to be perfected under Delaware and Oklahoma law, the Kansas Producers must have filed UCC–1 financing statements in both states, or perfected their security interest in another proper method under the state's respective versions of Article 9, such as by obtaining control over the Debtors' deposit accounts.

To the extent that the Kansas Producers have failed to perfect their security interests under Delaware and/or Oklahoma law, they are the holders of unperfected security interests, assuming they meet the other requirements set forth in Kansas § 9–339a. As noted above, whether the law governing priority of security interests is that of Kansas, Oklahoma, or Delaware, unperfected security interests are subordinate to properly perfected security interests, such as the one claimed by the Banks in this case. Under Kansas law, K.S.A. § 84–9–322(a)(2) provides that "[a] perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien." As noted above, this same language also has been adopted in all other relevant states.

[35] Accordingly, the Court holds that a security interest perfected only in Kansas will be subordinate to a security interest that was duly perfected against the Debtors in the appropriate state. Consequently, the Kansas Producers' motion for summary judgment is denied, and the Banks' motion for summary judgment is granted.[18]

V. *CERTIFICATION FOR DIRECT APPEAL*

As noted at the outset of this Opinion, the Court rules today on a true question of first impression. The Court has little doubt that this decision will be appealed.

***111** [36] Recent amendments to title 28 of the United States Code afford this Court the option to certify a matter for direct appeal to the Circuit Court of Appeals, assuming certain criteria are met; the decision of whether to take the appeal rests, of course, with the Court of Appeals. Direct appeals are governed by 28 U.S.C. § 158(d)(2), which provides, in relevant part, as follows:

> (2) (A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the

request of a party to the judgment, order, or decree described in such first sentence, or all of the appellants and appellees (if any) acting jointly, certify that—

(i) the judgment, order or decree involves a question of law as to which there is no controlling decisions of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken; and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

In the present case, the Court finds that the statutory criteria are met: there is no governing law on the issue before the Court, and it appears that prompt consideration of the appeal may serve to advance these bankruptcy proceedings. This last point is especially true given that the Debtors have recently filed a plan of reorganization and have expressed an intention to seek confirmation of such plan and emerge from bankruptcy in September, 2009. Accordingly, the Court deems it appropriate to certify this matter *sua sponte* for direct appeal to the United States Court of Appeals for the Third Circuit.

VI. *CONCLUSION*

For the foregoing reasons, the Court finds that a security interest perfected only in Kansas by virtue of Kansas § 9–339a will be subordinate to a security interest that was duly perfected against the Debtors in the appropriate state. Accordingly, the Court will deny the Kansas Producers' motion for summary judgment, and grant the Banks' motion for summary judgment.

An appropriate order follows.

ORDER

AND NOW, this **19th** day of **JUNE, 2009,** upon consideration of the Plaintiffs' Motion for Summary Judgment on Phase I Issues [Docket No. 161], filed by certain Kansas producers of oil and gas (the "Kansas Producers"); Bank of America, N.A.'s Motion for Summary Judgment on the Threshold Questions of Law [Docket No. 164], filed by Bank of America, N.A., as administrative agent for the debtors' pre-petition lenders (the "Banks"); J. Aron & Company's Consolidated Motion for Summary Judgment [Docket No. 152], filed by J. Aron & Company ("J. Aron"), an intervening party; and the joinders thereto as reflected on the docket in this adversary proceeding; for the reasons set forth in the accompanying Opinion, it is hereby

*112 **ORDERED,** the Court will grant in part the Motion of the Banks and deny the Motion of the Texas Producers; and this matter is

CERTIFIED, for direct appeal to the United States Court of Appeals for the Third Circuit pursuant to 28 U.S.C. § 158(d)(2)(A).

All Citations

407 B.R. 82, 171 Oil & Gas Rep. 658, 69 UCC Rep.Serv.2d 212

Footnotes

1 This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052.

2 The Court notes that the Producers Committee is, by design, not a party to this litigation.

3 One of the Debtors, SemCrude, also maintained a bank account in Massachusetts with Bank of America, and a de minimis account with First State Bank in Dumas, Texas. The latter account had a balance of less than $5,000 on the Petition Date. (SemCrude, L.P. First Amended Schedules/Statements, Sch. B [Case No. 08–11525, Docket No. 1926]).

4 The events giving rise to these bankruptcy proceedings have been the subject of an extensive investigation by a Court-appointed examiner. (*See* Final Report of Louis J. Freeh, Bankruptcy Court Examiner, dated April 15, 2009 [Case No. 08–11525, Docket No. 3701]). The Court's remarks in Section II are intended as background only.

5 The Debtors have stipulated to the extent, validity and priority of the Banks' security interests. (*See* Final Order Under 11 U.S.C. §§ 105, 361, 362, 363(c), 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1), and 364(e) and Fed. R. Bankr.P.2002, 4001 and 9014(I) Authorizing Debtors to Obtain Postpetition Financing, (II) Authorizing Debtors to Use Cash Collateral, and (III) Granting Adequate Protection to Prepetition Secured Parties, at 3 [Case No. 08–11525, Docket No. 1420]). Pursuant to the Producer Claims Procedures Orders (defined and described infra), final determination of the validity of the Banks' liens is reserved for further proceedings. At this stage, the parties seek a declaratory judgment regarding the relative priority of the Banks' security interests (assuming their validity for the moment) as against the rights of the Kansas Producers under applicable state law.

6 The Court's knowledge of this industry is informed by expert reports and affidavits submitted by the parties in support of their respective summary judgment motions.

7 Because of the similarity of Kansas § 9–339a and a Texas statute that is currently being interpreted by the Court in a related, contemporaneously-filed proceeding, styled *Arrow Oil & Gas, Inc. v. SemCrude, L.P.,* Case No. 08–51444, the Kansas Producers have adopted the arguments and authorities noted in the briefs of the Oil and Gas Producers in that proceeding, to the extent that they also apply to Kansas § 9–339a. (*See* Ks. Pls. Opp. Br. at 4). Likewise, at oral argument the Kansas Producers and the Banks adopted or incorporated by reference relevant points raised in oral argument in the Texas adversary proceeding. Accordingly, the Court will address these incorporated arguments throughout this opinion as if they were made by the Kansas Producers, to the extent that they apply to Kansas § 9–339a.

8 The definition of "first purchaser" also states that:

> [t]o the extent the operator receives proceeds attributable to the interest of other interest owners from a third-party purchaser who acts in good faith under a division order or other agreement signed by such operator the operator shall be considered to be the first purchaser of the production for all purposes under this section, notwithstanding the characterization of other persons as first purchasers under other laws or regulations. To the extent the operator has not received from the third-party purchaser proceeds attributable to the operator's interest and the interest of other interest owners, the operator is not considered the first purchaser for the purposes of this section, and is entitled to all rights and benefits under this section. Nothing herein shall impair or affect any rights otherwise held by a royalty owner to take its share of oil or gas in kind or receive payment directly from a third-party purchaser for such royalty owner's share of oil or gas production with or without a previously made agreement.

Id.

9 The issue of the Kansas Producers' rights with respect to the statutory lien provided by Kansas § 9–339a is not currently before the Court.

10 Kansas § 9–102(a)(9) defines "cash proceeds" as "proceeds that are money, checks, deposit accounts, or the like." K.S.A. § 84–9–102(a)(9).

11 The Kansas Producers do make one other argument in which they discuss Kansas § 9–324(g), which governs priority between competing PMSIs in the same collateral. Because the Banks do not have or assert PMSI security interests, however, the Court need not address this argument.

12 Oklahoma does have a lien statute that serves a similar purpose, but these liens are separate and distinct from Article 9 security interests, as well as subordinate to perfected security interests under Oklahoma law. *See Arkla Exploration Co. v. Norwest Bank of Minneapolis,* 948 F.2d 656, 660 (10th Cir.1991).

13 The Court also notes that Delaware, Oklahoma and Kansas have each adopted choice of law statutes that are identical in all material respects: Article 9's standard choice of law provisions.

14 Lest there be any confusion, the Kansas Producers make this argument with regard to the security interest created by Kansas § 9–339a(a), not the lien created by Kansas § 9–339a(d). As noted above, interpretation of Kansas § 9–339a(d) is not before the Court at this time. But the presence of subsection (d) does show that the Kansas Legislature drew distinctions between a lien and a security interest when it enacted Kansas § 9–339a.

15 Both Kansas and Delaware have adopted the exact same language regarding the scope of their respective versions of Article 9 in all respects material to this dispute. Accordingly, in order for the Kansas Producers' security interest to be

outside the scope of Delaware's version of Article 9, it would also have to be outside the scope of Kansas' version of Article 9. The Kansas Legislature clearly did not intend for this to be the case, given that Kansas Article 9 governs Kansas § 9–339a to the extent it is not displaced by the statute.

16 Subject to narrow exceptions for property more closely affiliated with real property than normal personal property, such as fixture filings and, as noted below, security interests in "as-extracted collateral."

17 No party has asserted that there is an agreement between the Bank of Oklahoma and the Debtors that calls for the application of any law other than Oklahoma.

18 On account of its ruling regarding choice of law, the Court does not reach the constitutional and other challenges that the Banks and J. Aron have asserted against Kansas § 9–339a.

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