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## **Recent Cases in Midstream Oil & Gas Bankruptcies**

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Particularly in this volatile economic environment, midstream oil and gas companies may find themselves in need of guidance when counterparties declare bankruptcy. From *SemCrude*, itself a midstream company, to *Energystec*, the bankruptcy landscape is rapidly changing. This paper, though not attempting to provide an exhaustive list of issues to consider, discusses some more recent decisions in bankruptcy law that midstream companies may find relevant in their own practice.

### **I. The Impact of the Recent *SemCrude* Decision**

In 2008, SemGroup and its affiliates filed for chapter 11 bankruptcy, leading to years of decisions that directly impact the midstream oil and gas industry. Just weeks ago, on July 30, 2015, the United States District Court for the District of Delaware issued a long-awaited decision, affirming and adopting the proposed findings of fact and conclusions of law of the Delaware Bankruptcy Court.<sup>2</sup> In *J. Aron*, a group of oil producers who sold oil to SemCrude were sued in the bankruptcy court by a group of purchasers, who bought that same oil from SemCrude. Those purchasers sought declaratory relief as to their rights in the disputed oil and their obligations to the producers. Three holdings from *J. Aron* are of prime significance, the first two related to the status of producers' liens on the purchased oil and gas and the third concerning constructive trusts under Oklahoma law.

#### **A. Purchases Free and Clear of Liens—Defenses Under the U.C.C.**

##### **1. "Buyer for Value" Defense**

Under U.C.C. § 9-317, a purchaser takes free and clear of all liens as a buyer for value if: (a) the purported liens were unperfected; (b) the buyers gave value; and (c) the buyers did not have any actual knowledge of the alleged security interests.<sup>3</sup> In dispute in *J. Aron* were the first and last elements. In adopting the bankruptcy court's proposed conclusion that the producers' liens were unperfected, the *J. Aron* court explained and adopted the reasoning of two adversary proceedings decided in bankruptcy court during the pendency of the SemCrude bankruptcy.<sup>4</sup>

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<sup>2</sup> *J. Aron & Co. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 2015 WL 4594516, No. 14-00041-SLR (D. Del., July 30, 2015) ("*J. Aron*"). The opinion from Judge Brendan Linehan Shannon of the United States Bankruptcy Court for the District of Delaware is *J. Aron & Co. v. SemCrude, L.P., (In re SemCrude, L.P.)*, 504 B.R. 39 (Bankr. D. Del. 2013).

<sup>3</sup> *J. Aron*, 2015 WL 4594516, at \*8.

<sup>4</sup> *Arrow Oil & Gas, Inc. v. SemCrude, L.P. (In re SemCrude L.P.)*, 407 B.R. 112 (Bankr. D. Del. 2009) ("*Arrow*") and *Mull Drilling Co., Inc. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 407 B.R. 82 (Bankr. D. Del. 2009) ("*Mull Drilling*").

In *Arrow* and *Mull Drilling*, the bankruptcy court was faced with a choice-of-law issue, namely whether to apply automatic perfection provisions embodied in the law of the states where the oil was drilled, Texas and Kansas law respectively,<sup>5</sup> or where the debtors themselves were located. In both cases, the bankruptcy court concluded that the conflict of laws provision of Delaware<sup>6</sup> applied, which directed that the jurisdiction in which the debtor is located governs the issue of perfection.<sup>7</sup> Because all of the SemCrude entities were located (for the purpose of the U.C.C.) in Delaware and Oklahoma, those states' perfection laws applied. Therefore, because the SemCrude debtors were not located in Kansas and Texas, the automatic perfection rule did not apply, and because no financing statement was filed, as is required under both Oklahoma and Delaware law, the bankruptcy court concluded that the liens were unperfected.<sup>8</sup>

In adopting the proposed findings of fact and conclusions of law, the district court explicitly agreed with the bankruptcy court's decisions in *Mull Drilling* and *Arrow*, providing further support for the notion that lienholders should be vigilant in ensuring that their security interests are, in fact, perfected. Because the district court further found insufficient evidence that could lead a reasonable jury to find that the purchasers took with actual knowledge of the producers' liens, it affirmed the purchasers' buyer for value defense.<sup>9</sup>

## 2. "Buyer in the Ordinary Course of Business" Defense

The district court further adopted the reasoning of the bankruptcy court below with regards to the "buyer in the ordinary course of business" defense of U.C.C. § 9-320(a). It found that all elements of the defense were met: (a) the purchaser bought in good faith; (b) without knowledge that the sale violated the rights of the lienholders in the goods; (c) in the ordinary course of business; and (d) not in partial or total satisfaction of a money debt.<sup>10</sup> The district court quickly dispensed with any arguments that the first two elements were not met. It spent more time, however, discussing the latter two elements.

In order to invoke the buyer in the ordinary course of business defense, the purchasers must have bought the goods from "a person in the business of selling goods of that kind."<sup>11</sup> In *J. Aron*, the producers argued that they had a relationship with SemGroup, the parent holding company that does not buy or sell oil, and not SemCrude, the subsidiary who regularly sold oil.<sup>12</sup> The district court looked at the definition of "person" under the U.C.C.,<sup>13</sup> and concluded that the

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<sup>5</sup> Tex. Bus. & Comm. Code § 9.343 and Kan. Stat. Ann. § 84-9-339a.

<sup>6</sup> 6 Del. Code § 9-301(1).

<sup>7</sup> *Arrow*, 407 B.R. at 137; *Mull Drilling*, 407 B.R. at 110.

<sup>8</sup> *Arrow*, 407 B.R. at 137; *Mull Drilling*, 407 B.R. at 110. This result would have been different had the court applied the law of a state with automatic perfection, such as Kansas or Texas.

<sup>9</sup> *J. Aron*, 2015 WL 4594516, at \*10.

<sup>10</sup> U.C.C. § 1-201(b)(9).

<sup>11</sup> *Id.*

<sup>12</sup> *J. Aron*, 2015 WL 4594516, at \*11.

<sup>13</sup> U.C.C. § 1-201(b)(27).

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