

PRESENTED AT

2016 Fundamentals of Oil, Gas and Mineral Law

April 14, 2016
Houston, Texas

Redetermination, Perfection and Bankruptcy in the Oilfield

Eric R. Goodman

REDETERMINATION, PERFECTION AND BANKRUPTCY IN THE OILFIELD

Mr. Eric Goodman¹

POTENTIAL BANKRUPTCY ISSUES

| | | |
|------|---|----|
| I. | Avoidance Actions..... | 1 |
| A. | Lien Creditor and Good Faith Purchaser (11 U.S.C. § 544)..... | 2 |
| B. | Preferential Transfers (11 U.S.C. § 547) | 3 |
| C. | Fraudulent Transfers (11 U.S.C. § 548)..... | 4 |
| D. | Application to Oil and Gas Industry | 4 |
| II. | Property of the Estate..... | 7 |
| A. | General Scope of Bankruptcy Estate | 7 |
| B. | Funds Held in Trust | 7 |
| C. | Application to Oil and Gas Industry | 8 |
| III. | Executory Contracts..... | 9 |
| A. | Anti-Assignment and <i>Ipso Facto</i> Clauses..... | 13 |
| B. | Section 365(c)(1) Contracts | 14 |
| C. | Actual versus Hypothetical Tests..... | 19 |
| D. | Application in the Oil and Gas Industry | 21 |
| IV. | Setoff and Recoupment..... | 24 |
| A. | Setoff and Section 553 of the Bankruptcy Code..... | 24 |
| B. | Recoupment | 27 |
| C. | Application to Oil and Gas Industry | 29 |

I. AVOIDANCE ACTIONS

A debtor's ability to avoid transfers that occurred prior to a bankruptcy filing are generally set forth in section 544 (lien creditor and good faith purchaser), section 547 (preferences), and section 548 (fraudulent transfers) of the Bankruptcy Code.

¹ Mr. Eric Goodman is a Partner with Baker Hostetler LLP in Cleveland, Ohio and is a member of the firm's Bankruptcy, Restructuring and Creditors' Rights Practice Group. The views express herein shall not be attributed to Baker Hostetler LLP or any of its clients. The author would like to thank Mr. R. Kevin Saunders, an Associate with Baker Hostetler LLP in Cleveland, Ohio, for his assistance in preparing these materials.

A. Lien Creditor and Good Faith Purchaser (11 U.S.C. § 544)

- Unperfected Security Interest in Personal Property—Section 544 of the Bankruptcy Code gives a debtor the “strong-arm” powers of a judicial lienholder who obtained a lien as of the petition date. The priority of liens on a debtor’s personal property will be determined by the Uniform Commercial Code and state law.

Using its strong-arm powers, a debtor can avoid security interests in personal property that were granted prepetition but which were not perfected prepetition. An interest in personal property can be perfected by properly recording a financing statement outside of the preference period (discussed below), providing constructive notice to the world of the lien interest, or having possession of the collateral.

- Unrecorded Interests In Real Property—Section 544 of the Bankruptcy Code also gives a debtor the strong-arm powers of a bona fide purchaser of real property. Under the Uniform Commercial Code and state law, a bona fide purchaser of real property has the ability to cut-off an unrecorded security interest in real estate.

Using its strong-arm powers, a debtor can avoid a lien on real estate if the lien is not recorded prepetition or within the applicable look-back period. A lien in real estate can be perfected by recording a copy of the mortgage or other document creating the lien in the county where the property at issue is located. In addition, an ownership interest in real estate that is not recorded may withstand a challenge under section 544 if the buyer/owner is in open and notorious possession of the property.

- Considerations Under Texas Law—Under Texas law,² an oil and gas lease is a real property interest.³ Once the oil and gas is extracted, the related production and payments themselves may be viewed as personal property. Perfecting the real property interest may not result in a perfected personal property interest in production. In order to obtain a single, uninterrupted

² The treatment of oil and gas leases—*i.e.*, as personal or real property—varies from state to state. In some states, *e.g.*, New York, oil and gas leases are considered personal property. *See* N.Y. GEN. CONSTR. § 39 (2015); *Wiser v. Enervest Operating, LLC*, 803 F.Supp.2d 109, 116 (N.D.N.Y. 2011); *Wagner v. Mallory*, 62 N.E. 584, 505 (N.Y. 1902); *accord Backar v. W. States Producing Co.*, 547 F.2d 876, 881-82 (5th Cir. 1977); 1 N.Y. LAW & PRACTICE OF REAL PROPERTY § 1.8 (2d ed. 2015). How an oil and gas lease is treated for purposes of state law can impact the respective rights of the parties thereto under the Bankruptcy Code.

³ *See, e.g., Terry Oilfield Supply Co. v. Am. Sec. Bank, N.A.*, 195 B.R. 66, 70-71 (S.D. Tex. 1996) (“A mineral lease in Texas is a determinable fee. It is not a lease or other form of executory contract that a debtor may accept or reject. Because a mineral lease is a fee interest, an assignment of an interest under that lease conveys a real property right not merely a chose in action.”); *Wilson v. Parson (In re Jones)*, 77 B.R. 541, 544-45 (Bankr. N.D. Tex. 1987) (“Under Texas law, an interest in an oil and gas lease is an interest in the minerals in the ground. Thus, it is real property.”); *Phillips Petroleum Co. v. Adams*, 513 F.2d 355, 363 (5th Cir. 1975) (“Texas law provides that oil and gas are realty when in place and personalty when severed from the land by production.”)

lien in oil and gas production, a creditor may need to hold a real property lien that covers the oil and gas while it is in the ground and a personal property lien that covers the oil and gas once it is extracted.⁴

B. Preferential Transfers (11 U.S.C. § 547)

- Transfers Within 90 Days of Bankruptcy—Section 547 of the Bankruptcy Code allows a debtor to “avoid” payments made or liens granted to creditors in the 90 days before the bankruptcy was filed.

The purpose of the preference section of the Bankruptcy Code is to ensure that no single creditor is favored by the debtor in the days and months immediately preceding the debtor’s bankruptcy filing. Preferences are a “no fault” claim, meaning that the parties’ intent is irrelevant as long as the statutory elements are met.

- Elements of Action—To succeed on a preference claim, a debtor must prove the following elements: (i) there was a “transfer of an interest of the debtor in property;” (ii) the transfer was made “for or on account of an antecedent debt owed by the debtor;” (iii) the transfer was made while the debtor was insolvent (insolvency is presumed); (iv) the transfer was made within 90 days of the petition date (or one year, if the creditor is considered an “insider”); and (v) the transfer allowed the creditor to receive more than it would have received in a chapter 7 liquidation. The phrase “interest of the debtor in property” is broadly defined to include paying amounts due under a contract, granting a lien or security interest in the debtor’s property, or waiving rights the debtor otherwise would have had.
- When a Transfer Is Deemed to Occur—Under section 547 of the Bankruptcy Code, a transfer of a security interest is deemed to occur at the time the security interest takes effect between the transferor and the transferee provided that such security interest is perfected at, or within, 30 days after the security interest arises. If the security interest is perfected after this time period, the transfer is deemed to occur at the time of perfection.

⁴ See *Am. Nat’l Bank v. U.S. (In re Hawn)*, 149 B.R. 450, 455 (Bankr. S.D. Tex. 1993) (“Under Texas law where a creditor has a security interest which is perfected both as a deed of trust on the minerals in the ground and perfected under Article 9 after extraction, as here, the resulting interest is a single continuous security interest that attaches while the minerals are in the ground and continues after extraction.”); *Hess v. The Bank of Oklahoma (In re Hess)*, 61 B.R. 977, 979 (Bankr. N.D. Tex. 1986) (“When oil and gas are produced, they are the same oil and gas which were under the ground, and are still owned by the landowner (or his Mineral lessee). When oil and gas are produced, they become personal property and the lien of the Bank on the real estate is subject to being lost unless the Bank’s security documents cover Production and are properly perfected as to personal property....The change of legal designation from real property to personal property does not dislodge the Debtors’ ownership nor the Bank’s liens. In effect, the Bank has a continuing lien on the oil and gas, wherever located.”)

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: Redetermination, Perfection and Bankruptcy in the Oilfield

Also available as part of the eCourse

[2016 Fundamentals of Oil, Gas and Mineral Law eConference](#)

First appeared as part of the conference materials for the
2016 Fundamentals of Oil, Gas and Mineral Law session

"Basics: Redetermination, Perfection and Bankruptcy in the Oilfield"