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Mechanic's and Materialman's Liens on Oil and Gas Properties in Texas

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Prior articles in our series demonstrated ways to stretch a borrowing base and how to address defaults on oil and gas loans. If a producer ultimately finds itself with a shrunken borrowing base and limited liquidity, the producer in turn might not be able to pay balances due to its contractors. An unpaid contractor may be able to file a mechanic's and materialman's ("M&M") lien on the producer's mineral property. An M&M lien will encumber the producer's oil and gas property, and by extension, its secured lender's collateral. Depending upon the facts, the M&M lien could prime the secured lender's lien. In any event, the existence of an M&M lien could violate a negative covenant in the producer's credit agreement, resulting in a default. This alert provides an overview of the process for filing M&M liens on mineral property in Texas.

Mineral Property Liens Generally

Under Chapter 56 of the Texas Property Code, a contractor that provides services or materials which facilitate the production of hydrocarbons can file a lien on mineral property for amounts which have not been paid to it. Texas and other long-time producing states, such as Oklahoma and Louisiana, have laws which specifically cover oil field M&M liens, although there are differences between the laws of each state.¹ In Texas, these statutes differ from the general real estate M&M lien statutes found in Chapter 53 of the Texas Property Code, which are used by other types of contractors such as those working on home and office construction projects. Many other states, such as Alabama and West Virginia, do not have specific statutes relating to M&M liens on mineral property. In those states, an unpaid E&P service provider may only rely on the same general M&M lien statutes used by other types of contractors.

Who Can File under Chapter 56?

A lien on mineral property can be filed by a mineral contractor or subcontractor who provides material or services for "mineral activities." Mineral activities are defined by statute as "digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry." In the oil and gas context, the general proposition is that the labor or materials must facilitate the potential production of oil and gas.

In determining whether work is considered a "mineral activity" gray areas may exist where the labor indirectly facilitates the potential production of hydrocarbons. Courts will likely utilize more traditional definitions of "labor" when testing the validity of an M&M lien. For example, services such as plumbing work done for an offshore rig can be considered a mineral activity.²

¹ For example, under the Texas statutes the lien affidavit filed in the county records must contain an itemized list of the amounts claimed while this is not required under the Oklahoma statute.

² See *Sun Coast Plumbing Co., Inc. v. Shell Offshore, Inc.*, 2010 U.S. Dist. LEXIS 34139 (S.D.Tex. 2010).

What Property is Subject to an M&M Lien under Chapter 56?

Under Chapter 56 a lien can attach to the “land, leasehold, oil or gas well, water well, oil or gas pipeline ... and lease for oil and gas purposes” for which the materials were provided or the services were performed. A Chapter 56 lien applies to the entire oil and gas leasehold upon which the well is located.³ However, M&M liens on a producer’s leasehold will not affect the mineral interest owned by the lessor. Additionally, it is unclear under Texas law whether an M&M lien will extend to the proceeds of production from the wells.⁴

When times are tight and resources are limited, in making difficult decisions about whom to pay producers should be mindful about what property will become encumbered. Even though a contractor may have provided services on what ultimately became a dry hole, if the work was done on a large lease which also has a highly productive well, the lien may attach to all wells located on the lease, including the highly productive well.

Additionally, a lien can be filed on the material the contractor provided as well as other personal property of the owner related to the production of hydrocarbons.

What are the Filing Requirements?

To file a lien under Chapter 56, a sworn lien affidavit must be filed in the real property records of the county where the mineral property is located. The notary must certify that the contents of the filing are sworn to and affirmed by the claimant or representative. This certification is referred to as a “jurat” and is necessary for a statement to qualify as an affidavit. A lien claim will be invalid if a notary merely acknowledges that the claimant or representative personally appeared before the notary and that a document was executed for a particular purpose. The affidavit must contain the following information:

- the name of the mineral property owner involved, if known;
- the name and mailing address of the claimant;
- the dates of performance or furnishing;
- a description of the land, leasehold interest, pipeline, or pipeline right-of-way involved;
- an itemized list of amounts claimed.

The affidavit must be filed within six months after the date “indebtedness accrues.” For labor performed by the day or week, indebtedness begins to accrue at the end of the day or week during which the labor was performed. For all other material or services, indebtedness accrues on the last date the services or materials were provided. Services and materials provided for the same land or leasehold are considered to be part of a single contract unless more than six months pass between the dates when services or materials are provided.

Additionally, if a subcontractor is filing the lien, written notice must be given to the owner of the property at least 10 days prior to filing the lien. The notice must contain the amount of the lien, the name of the person indebted to the subcontractor, and a description of the property. The subcontractor’s lien affidavit must include a statement indicating that this requirement has been met and must also include the name of the party indebted to the filing subcontractor. Once the owner receives this notice, the owner may withhold this amount from the original contractor.

³ See *Walthers v. Hermat Oilfield Servs. (In re Reichmann Petroleum Corp.)*, 373 Fed.Appx. 497 (5th Cir. 2010).

⁴ Compare *Abella v. Knight Oil Tools*, 945 S.W.2d 847 (Tex. App.—Houston [1st Dist.] 1997, no writ) with *Wilkins v. Fecht*, 356 S.W.2d 855 (Tex.Civ.App.—San Antonio 1962, writ ref’d).

Subcontractors should be aware that a mineral property owner will only be liable to the subcontractor for any amounts that are unpaid under the original contract. Consequently, if the owner has already paid the general contractor in full, the owner will not be liable to the subcontractor. For this reason, subcontractors should not delay filing lien claims if they are owed money by a general contractor that is experiencing financial difficulties.

In the M&M lien affidavit, the property description of the land must be legally sufficient. Merely referring to certain wells in the lien affidavit does not qualify as a legally sufficient description.⁵

Over What Interests Will the M&M Lien Have Priority?

A perfected M&M lien relates back to the date when the services or materials were provided. Energy lenders should be aware that an M&M lien holder will have priority over a lender's security interests in the same collateral if the lender perfects these interests after the M&M lien holder first provided services or materials.

Enforcement

Chapter 56 states that a lien must be enforced in the same manner and time period as a general M&M lien under Chapter 53, the general M&M lien code section. Under Chapter 53, a party must bring suit to foreclose a non-residential lien within the latter of two years from the filing of the lien or within one year of completion of work under the original contract.

Conclusion

With the drastic decline in crude prices, there will likely be an increase in unpaid amounts owed to providers of services and materials related to the production of oil and gas. Contractors waiting on payment for past due amounts should contact an attorney for assistance in utilizing an M&M lien claim to recover unpaid balances. Similarly, energy lenders and producers should consider consulting with an attorney to determine how best to protect their collateral and property.

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⁵ *In re Reichmann Petroleum Corp.*, 2009 U.S. Dist. LEXIS 30983 (S.D. Tex. 2009).