

Oklahoma Strengthens Lead Over Texas in First Purchaser Protection Matchup in *In re First River Energy, LLC*

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We discussed in the March 2020 edition of the *Texas Bar Journal*¹ the bankruptcy court ruling by Judge Craig A. Gargotta of San Antonio in *In Re First River Energy LLC* that oil and gas producers in Texas do not hold perfected security interests in oil and gas well proceeds, notwithstanding the Texas Legislature's efforts to protect producers and royalty owners following the downturn in the 1980s. The Fifth Circuit recently reaffirmed Judge Gargotta's decision.

In the wake of a decline in oil prices in the 1980s, Texas and Oklahoma, among other oil and gas producing states, passed new laws to secure the rights of royalty owners and producers for amounts owed to them for their oil and gas produced and sold by third parties. In 2009, these "first purchaser statutes" were challenged and the court in *In re SemCrude, L.P.* held that the security interests created by the Texas and Oklahoma statutes failed to prime the bank's security interests in the same assets. As a result, Oklahoma amended its statute to better protect royalty owners and producers, but Texas did not. This proved to be problematic for Texas producers in a subsequent case, *In re First River Energy, LLC*, which prompted many to wonder whether the Texas legislature would follow Oklahoma's lead.

First Purchaser Statutes and *SemCrude*

Texas and Oklahoma each initially passed their first purchaser statutes in the 1980s; the Texas legislature added Section 9.343 (formerly Section 9.319) to the Texas Business and Commerce Code in 1983, referred to as the Texas First Purchaser Statute, and the Oklahoma legislature passed the Oklahoma Oil and Gas Owner's Lien Act in 1988 (1988 Act). The goal of these statutes was to secure the rights of royalty owners and producers to receive payment for their shares of production from the first purchaser of such production, often the operator of the assets. Unfortunately for royalty owners and producers, these statutes proved ineffective when challenged in *In re SemCrude, L.P.* The court in *SemCrude* found that the jurisdiction where the first purchaser is located, rather than where the oil and gas are produced, governs which uniform commercial code (UCC) shall apply. Unfortunately for the Texas interest owners in *SemCrude*, this meant they could not take advantage of the Texas UCC or its non-standard first purchaser provision. Additionally, Oklahoma's 1988 Act expressly provided that liens created thereunder did not impair the priorities of other security interests under Oklahoma's UCC. The decision meant that the Texas and Oklahoma interest owners in *SemCrude* were left largely unprotected by their first purchaser statutes.

In response to the decision in *SemCrude*, Oklahoma passed the Oil and Gas Owners' Lien Act of 2010 (2010 Act). Under the new statute, interest owners are granted a lien in connection with their real property interest in "oil and gas rights" (as defined in the 2010 Act) rather than a security interest, which serves as a claim against personal property. Unlike the 1988 Act, the 2010 Act creates a lien that arises under Oklahoma property law and is not governed by the UCC.

Additionally, the 2010 Act provides that such a lien takes priority over other security interests or liens without requiring any action, including the filing of a financing statement.

First River

The effectiveness of the 2010 Act was recently tested in *In re First River Energy, LLC*. First River Energy, LLC, a Delaware limited liability company, owed Texas and Oklahoma producers for oil and gas purchased from such producers. When First River filed for bankruptcy, Texas producers argued that they had secured claims under the Texas First Purchaser Statute. Oklahoma producers argued that they held a first, prior and automatically perfected lien pursuant to the 2010 Act. The court reaffirmed the decision in *SemCrude* with respect to the Texas producers, finding that the Delaware UCC would apply because the first purchaser, First River, was formed in Delaware. Like in *SemCrude*, this meant that the Texas producers who had not filed financing statements to secure their interests (as required by the Delaware UCC) were unsecured and subordinate to other perfected security interests. The Oklahoma producers, however, were more fortunate. The court held that Oklahoma interest owners would have a superior lien right under the 2010 Act so long as they could demonstrate they held “oil and gas rights” under the statute.

On appeal, the Fifth Circuit recently affirmed the lower court ruling in a February 3rd opinion by Circuit Judge Edith H. Jones. With respect to the Texas producers’ security interests, the Fifth Circuit held that the Delaware UCC applied, leaving such producers who had not filed financing statements unsecured. Those who had filed financing statements had done so after First River’s secured lenders and the producers’ interests were therefore subordinate to such secured lenders’ first-priority security interest. The court also discussed the actions of the Oklahoma legislature to cure the defects in the state’s 1988 Act highlighted in *SemCrude*, and upheld the lower court ruling that the 2010 Act creates an automatically perfected first-priority lien outside of the governance of the UCC. Judge Jones noted that interest owners in Texas “must beware ‘the amazing disappearing security interest’ and continue to file financing statements,” and that “the Texas legislature should take note.”

For those keeping track, in the matchup since *SemCrude*, the score is now Oklahoma 2, Texas 0. Unlike Oklahoma, Texas has yet to amend its first purchaser statute to correct the defects highlighted in *SemCrude* and *In re First River Energy, LLC*. While Oklahoma’s 2010 Act has proven successful at better protecting the interests of Oklahoma royalty owners and producers, Texas interest owners should proceed with caution when relying on the Texas First Purchaser Statute.

The Fifth Circuit Decision in *In re First River Energy, LLC* can be found [here](#).

¹ To access the full article from the *Texas Bar Journal*, [click here](#).