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In re First River Energy LLC: The Agent vs. the Producers



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Deutsche Bank Trust Co. Americas v. First River Energy LLC (*In re First River Energy LLC*) is a tale of conflicts (of laws), dueling liens and black gold. Here is a summary of the cast:

- Lenders: Deutsche Bank AG New York Branch, other banks and financial institutions;
- Agent: Deutsche Bank Trust Co. Americas;
- Borrower/Debtor: First River Energy LLC, a Delaware limited liability company;
- Producers: upstream oil and gas producers in Texas and Oklahoma; and
- Bankruptcy Judge: Hon. Craig A. Gargotta of the Western District of Texas.

Act I: Setting the Stage

Scene I: "We Can Do It"¹

The borrower wants to start a midstream oil and gas transportation business, but it needs money to run the show, so the borrower approaches lenders. The lenders make a loan to the borrower. To secure the obligations owed under the credit agreement, the borrower grants the lenders liens and security interests in substantially all of its assets, including all cash, accounts, inventory and all other goods, and the proceeds thereof. The agent for the lenders files a financing statement with the Delaware Division of Corporations and enters into an account control agreement with the borrower's bank, located "on Broadway" (in New York).

Scene II: "I Want to Be a Producer"²

The borrower enters into numerous agreements with the upstream producers to purchase oil and gas from wells that the upstream producers own in Texas and Oklahoma. The upstream producers understand that in Texas and Oklahoma, state law

provides sellers of oil and gas an automatically perfected security interest and a lien on the oil and gas that they sell (and the proceeds).³ No financing statement is required. As such, the upstream producers sell oil and gas to the borrower on credit without filing a financing statement. The upstream producers know that there is a risk that the production might flop, but they will have a lien on the proceeds once they "role" in, so they will get paid first from such proceeds.

Scene III: "You Never Say 'Good Luck' on Opening Night"⁴

The oil and gas market is an almost instant flop, and prices plummet; the borrower defaults on the credit agreement, the borrower does not pay the upstream producers for their oil and gas purchases in December, and the borrower files for bankruptcy in January.

Stage Right: "When You Got It, Flaunt It"⁵

The agent appears and shows everyone its properly perfected, first-filed financing statement and account control agreement.

A Crowded Stage Left: "Betrayed"⁶

One hundred and forty⁷ upstream producers appear, asserting that their interests are priming purchase money security interests (PMSI) and/or statutory liens in all oil and gas produced and sold to the borrower in Texas and Oklahoma and the proceeds thereof.⁸

¹ Mel Brooks, "We Can Do It," *The Producers* (2005).

² Brooks, "I Want to Be a Producer," *The Producers* (2005).

³ See, e.g., Tex. Bus. & Com. Code Ann. § 9.343(b); Okla. Stat. Ann. tit. 52, § 549.3-4.

⁴ Brooks, "You Never Say 'Good Luck' on Opening Night," *The Producers* (2005).

⁵ Brooks, "When You Got It, Flaunt It," *The Producers* (2005).

⁶ Brooks, "Betrayed," *The Producers* (2005).

⁷ Expedited Motion to Establish Procedures for the Resolution of Claims and Liens Against Estate Property, Case No. 18-50085, Docket No. 331, ¶ 19.

⁸ *Deutsche Bank Trust Co. Americas, Agent v. First River Energy LLC (In re First River Energy LLC)*, Adv. Case No. 18-05015-CAG, 2019 Bankr. LEXIS 749, at *18 (Bankr. W.D. Tex. March 7, 2019).

Center Stage: “There’s Nothing Like a Show on Broadway”⁹

Facing a deluge of litigation, debtor’s counsel rushes in, and the court grants their request to establish one adversary proceeding to serve as a declaratory judgment action to determine the extent, validity and priority of liens in all of the debtor’s oil and gas products and the proceeds from their sale.¹⁰

Act II: The Conflict of Laws: Priority and Perfection: “Goodbye!”¹¹

Texas Upstream Producers

Before the bankruptcy court could even reach the issue of the extent, validity and priority of the liens, it first had to determine the applicable law that governed the perfection of the security interests in the oil, gas and proceeds thereof.¹² This was a gating issue for the Texas upstream producers, who asserted an automatically arising, priming PMSI under the nonstandard provision in Texas’s version of the Uniform Commercial Code (UCC) granting these liens. The Texas upstream producers asserted that this nonuniform provision of the Texas UCC, § 9.343,¹³ not UCC § 9-301,¹⁴ governed perfection and priority of liens for oil produced in Texas. The bankruptcy court disagreed.

First, the bankruptcy court determined that it did not need to reach the issue of “whether the federal or forum (Texas) law applies,”¹⁵ because both Texas and Delaware adopted the UCC, which “is regarded as the federal law of commerce

regarding transactions including secured transactions.”¹⁶ UCC § 9-301 provides that the laws of the state in which the entity is organized determine which state’s substantive laws govern the perfection and priority of security interests in personal property.¹⁷

The agent and producers did not dispute that the debtor was organized under the laws of Delaware. Therefore, the bankruptcy court found that Delaware’s UCC, and more importantly UCC § 9-301, which was adopted in both Delaware and Texas, governed the perfection and priority of security interests in the debtor’s goods, inventory, accounts and proceeds.¹⁸ Moreover, by finding that Delaware rather than Texas law applied, the bankruptcy court mooted any Texas upstream producer’s argument that they had a priming PMSI that automatically arose under Texas law without the need for filing a financing statement.¹⁹

In order to perfect a security interest in goods, inventory, accounts and proceeds under Delaware law, a party must file a financing statement with the Delaware Division of Corporations.²⁰ Delaware also follows the “first-to-file-or-perfect rule,” which ranks the priority of multiple security interests in time-of-filing order.²¹ To the extent that any of the Texas upstream producers had filed a financing statement, the agent’s financing statement was first filed, therefore the agent’s security interest primed any later-filed financing statements.²²

With respect to security interests in cash proceeds held in deposit accounts, Delaware law provides that perfection is determined pursuant to the “local law of [the] bank’s jurisdiction.”²³ The blocked account-control agreement between the agent and debtor’s bank provided that New York was the bank’s jurisdiction.²⁴ Pursuant to New York law, a lien on a deposit account is perfected by control of that account.²⁵ The agent’s account-control agreement established the agent’s control over the deposit account, and none of the upstream producers had entered into a similar agreement with the debtor. Thus, the bankruptcy court found that the agent held a first-priority security interest in the debtor’s deposit account, which more than likely held the proceeds of the lender’s and the upstream producers’ collateral.²⁶

Oklahoma Upstream Producers

Meanwhile, the Oklahoma upstream producers had their own unique argument. The Oklahoma Lien Act gives rise to a lien in oil and gas, and the proceeds thereof, for oil and gas produced in Oklahoma, which is not an Article 9 lien “but rather arises as part of a real estate interest of the interest owner in the materials.”²⁷ This lien is automatic and “takes priority over any other lien, whether arising by contract, law, equity, or otherwise, or any security interest.”²⁸ Thus, under

9 Brooks, “There’s Nothing Like a Show on Broadway,” *The Producers* (2005).

10 *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *12-13.

11 Brooks, “Goodbye!,” *The Producers* (2005).

12 *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *32.

13 Tex. Bus. & Com. Code Ann. § 9-343 provides, in relevant part:

(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 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).

14 Del. Code Ann. tit. 6, § 9-301 provides:

Except as otherwise provided in Sections 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4), while negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(A) perfection of a security interest in the goods by filing a fixture filing;

(B) perfection of a security interest in timber to be cut; and

(C) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

(4) The 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.

15 *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *49 (internal quotations omitted).

16 *Id.* (internal quotations omitted) (quoting *Woods-Tucker Leasing Corp. of GA v. Hutcheson-Ingram Dev. Co.*, 642 F.2d 744, 749 (5th Cir. 1981)).

17 *Id.* at *56.

18 *Id.* at *50 (citing Del. Code Ann. tit. 6 § 9-301).

19 *Id.* at *60 (citing Tex. Bus. & Com. Code Ann. § 9.343(f)).

20 Del. Code Ann. tit. 6 § 9-310(a).

21 *Id.* at § 9-322(a)(1).

22 *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *58.

23 *Id.* (quoting Del. Code Ann. tit. 6 § 9-304(a)).

24 *Id.* at *58.

25 *Id.* at *59 (citing N.Y.U.C.C. § 9-312(b)(1)).

26 *Id.*

27 *Id.* at *41 (quoting Okla. Stat. Ann. tit. 52 § 549.3(A), cmt. a).

28 *Id.* (quoting Okla. Stat. Ann. tit. 52 § 549.7).

the Oklahoma Lien Act, Oklahoma upstream producers would have a security interest superior to the agent's for oil and gas and proceeds of oil and gas produced in Oklahoma. However, the bankruptcy court found that the Oklahoma upstream producers had not presented evidence of their oil and gas rights, but to the extent that they could demonstrate "that they have 'oil and gas rights' subject to an oil and gas lien under the Oklahoma Lien Act," then Oklahoma law would apply to determine the perfection and priority of the Oklahoma upstream producers' interest in oil and gas and the proceeds thereof for oil produced in Oklahoma.²⁹

Act III: The Direct Appeal

Finding that there were no controlling decisions, that resolution of the issues was of public importance, and that an immediate appeal would advance the bankruptcy case because the debtor had a defined amount of assets available for distribution to its creditors, the bankruptcy court certified two questions for direct appeal to the Fifth Circuit:³⁰

1. Does UCC § 9-301, which is the same in Texas and Delaware, dictate that Delaware law governs the perfection and priority of liens between Texas upstream producers and the agent where the personal property at issue is accounts receivable, cash, cash equivalents and inventory held by the debtor, an LLC organized under the laws of the state of Delaware?
2. Does UCC § 9-301, which is the same in Texas and Delaware, dictate that the law of the state where the debtor is incorporated determines the perfection and priority of security interests among the agent, a secured lender, and producers of oil and gas in Texas, regardless of the nonstandard provision located in § 9.343 of the Texas Business and Commerce Code?³¹

Conclusion

As one of the primary goals of the UCC is to promote "certainty and predictability in commercial transactions,"³² the facts presented in the *First River Energy* opinion show just how quickly the adoption of a few nonstandard UCC provisions, like those in Texas, or the imposition of certain state law statutory rights, like those in Oklahoma, can toss the UCC's order and reliability into chaos.

The agent and producers in *First River Energy* both had a legal basis to claim a first-priority security interest in certain of the borrower's assets. This reality provided enough uncertainty to lead to litigation. Further, the facts presented suggest a real question about the true character of an oil and gas interest: Is it real property or personal property?³³ While the producers and agents had their day in court, not all of the arguments were a hit for the producers.³⁴

Despite this instant outcome, there might be an encore for these players as the rest of this bankruptcy case plays out, because the agent asserts that it is oversecured.³⁵ In a typical priority dispute, the parties usually find themselves in an all-or-nothing situation. However, if the agent's claims can be fully satisfied from the borrower's collateral, there might be some hope of recovery for the upstream producers after all. **abi**

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²⁹ *Id.* at *44.

³⁰ As of the time of publication, the parties are briefing the merits of the direct appeal in the Fifth Circuit. *U.S. Energy Dev. Corp., et al. v. Deutsche Bank Trust Co., et al.*, No. 19-90012 (5th Cir.).

³¹ *In re First River Energy LLC*, 2019 Bankr. LEXIS 1284, at *12-13 (Bankr. W.D. Tex. April 22, 2019).

³² *Am. Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86, 92 (Tex. 2000).

³³ See also *HPIP Gonzalez Holdings LLC v. Sabine Oil & Gas Corp., et al. (In re Sabine Oil and Gas Corp.)*, 567 B.R. 869 (S.D.N.Y. 2017) (considering whether executory contracts with midstream gatherers ran with land or were executory contracts).

³⁴ *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *22-24. Without following *per se* the Delaware Bankruptcy Court's ruling in *Arrow Oil & Gas v. SemCrude LP (In re SemCrude)*, 407 B.R. 112 (Bankr. D. Del. 2009), the opinion in *First River Energy* references and relies on the reasoning set forth in the *SemCrude* opinion. Further, the opinion in *First River Energy* notes that the *SemCrude* opinion is the sole opinion published that addresses these issues.

³⁵ *In re First River Energy LLC*, 2019 Bankr. LEXIS 749, at *17.