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SOME COMMON ISSUES INVOLVED IN OIL AND GAS BANKRUPTCIES: A PRIMER FOR THE NON-BANKRUPTCY PRACTITIONER

James E. Babcock* & Robert O. Thomas**

In the past five years, various economic factors and political events have interacted to depress the once-thriving oil and gas industry to a point where, at times, it seems that the most active sector of the industry is now the bankruptcy courts. As a result, many practitioners, for the first time find themselves confronting a strange new body of law—Title 11 of the United States Code or, the Bankruptcy Code.

It would not be possible within the context of this article to fully discuss all of the possible ways in which oil and gas operations may be impacted by a bankruptcy. Nevertheless, an overview of several key concepts may be helpful to the Louisiana non-bankruptcy practitioners whose clients have engaged in business dealings with a person or entity that has voluntarily or involuntarily sought bankruptcy protection or who may, themselves, be contemplating bankruptcy. This article examines four key concepts under the Bankruptcy Code: (i) the automatic stay provision, (ii) adequate protection and cash collateral, (iii) voidable transfers and the “strong arm clause,” and (iv) executory contracts and unexpired leases, and the manner in which each impacts oil and gas operations.

INTRODUCTION

The Bankruptcy Code¹ is comprised of eight chapters, being the odd numbers from 1 through 15. Chapters 1, 3 and 5 contain provisions which apply generally to cases filed under chapters 7, 11 or 13.² Most cases involving oil and gas operations will be filed under chapter 7

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2. Member, Texas Bar.
3. Member, Texas and Louisiana Bars.
4. Hereinafter frequently cited as the Code.
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(liquidation) or chapter 11 (reorganization). Hence, the focus of this article is bankruptcy proceedings under those chapters.

A case is commenced under chapter 7 or chapter 11 by the filing of a petition. The filing of a voluntary petition under either chapter constitutes an order for relief under that chapter. In an involuntary proceeding, an order for relief will be entered only if the debtor does not timely controvert the allegations of the involuntary petition or, if after trial, the court finds that the debtor is generally not paying his debts as they become due.

The date upon which the petition is filed (the "petition date") is an important date in any chapter 7 or chapter 11 proceeding, as it serves as a measuring point for certain other actions in the bankruptcy proceeding. For instance, the automatic stay takes effect simultaneously with the filing of the petition. Also, the filing of a petition creates an estate, composed generally of "all legal or equitable interests of the debtor in property as of the commencement of the case."

Whether or not a transfer of an interest of the debtor in property constitutes a

3. In a chapter 7 liquidation a trustee is appointed to collect and reduce to money the property of the estate and to distribute it to the creditors of the estate. The debtor is then discharged from most prepetition debts. See generally 11 U.S.C. §§ 704-766 (1982 & Supp. II 1984).

4. Chapter 11 provides for the reorganization and rehabilitation of a business in financial difficulty as an alternative to liquidation. Generally, either a trustee or the debtor in possession operates the business until a plan of reorganization is formulated. Upon acceptance of the plan by the creditors and confirmation by the court, the debtor is discharged of all prepetition debts (with some exceptions) except as provided in the plan. See generally 11 U.S.C. §§ 1101-1174 (1982 & Supp. II 1984).


8. "Debtor" is defined generally as the person concerning which a bankruptcy proceeding has been commenced. 11 U.S.C. § 101(12) (1982 & Supp. II 1984). Unless a trustee has been appointed, the debtor will also be "debtor in possession," 11 U.S.C. § 1101(1) (1982), and will thus be armed with all of the rights, powers, and duties of a chapter 11 trustee. 11 U.S.C. § 1107 (1982 & Supp. II 1984). When used in this paper, the terms "debtor" and "trustee" should be understood to include the debtor in possession.

9. 11 U.S.C. § 303(h) (1982 & Supp. II 1984). Relief will also be granted if, within 120 days before the date of the filing of the petition, a custodian has been appointed to take possession of, or did take possession of the property of the debtor. Id.


preference is also determined partly by comparing the timing of the transfer to the petition date.\textsuperscript{12}

**THE AUTOMATIC STAY**

The automatic stay provision is, perhaps, the cornerstone of the Bankruptcy Code.\textsuperscript{13} It provides that the filing of a petition in bankruptcy shall operate as a stay of, among other things: (i) the commencement or continuation of any proceeding against the debtor which could have been commenced before the petition date to recover a claim against the debtor that arose before the petition date; (ii) any act to obtain possession of any property of the estate; (iii) the enforcement of any judgment against the debtor; (iv) the set-off of any debt; and (v) any act to create, perfect, or enforce any lien or privilege against property of the state.\textsuperscript{14} The stay is effective against a creditor\textsuperscript{15} whether or not such creditor has knowledge that a petition has been filed,\textsuperscript{16} and a knowing violation of the stay may be punished as a contempt of court and may subject the violator to an award of damages, including costs and attorneys fees, and, in appropriate circumstances, punitive damages.\textsuperscript{17} Any action taken in violation of the stay is void and without effect.\textsuperscript{18}

The scope of the automatic stay is extremely broad, encompassing not only all civil actions and proceedings, whether or not before a


\textsuperscript{13} The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy. Report of the Comm. of the Judiciary, S. Rep. No. 989, 95th Cong. 2d Sess. (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 5840 [hereinafter referred to and cited as the *Senate Report*].


\textsuperscript{15} "Creditor" is defined generally as an entity that has a claim against the debtor that arose prior to the entry of an order for relief including those "involuntary gap" creditors whose claims arose between the date of the filing of an involuntary petition and the entry of an order for relief and those creditors whose claims arose after the entry of an order for relief but before the entry of an order converting the case to a chapter 7 liquidation. 11 U.S.C. § 101(9) (1982 & Supp. II 1984).

\textsuperscript{16} In Re Miller, 22 Bankr. 479 (Bankr. D. Md. 1982); see also In Re Mann, 22 Bankr. 306, 309 (Bankr. E.D. Penn. 1982).


\textsuperscript{18} Borg-Warner Acceptance Corp. v. Hall, 685 F.2d 1306, 1308 (11th Cir. 1982); but see In Re Oliver, 38 Bankr. 245, 248 (Bankr. D. Minn. 1984) (court determined that case law regarding whether acts in violation of the automatic stay are void or voidable is inconsistent and held that, in light of bankruptcy court's power to ratify a state court judgment obtained in violation of the automatic stay, acts taken in violation of the stay are voidable rather than void.)
governmental tribunal, but any and all other attempts, including letters and telephone calls, to collect a prepetition debt. It continues in effect until the case is closed or dismissed, unless it is modified or terminated by the Bankruptcy Court on motion of a party in interest. The grounds for modification or termination of the stay are set out in Bankruptcy Code section 362(d) and include "the lack of adequate protection" of a secured creditor's interest in property of the estate.

Adequate Protection And Cash Collateral

"Adequate protection" is not defined in the Bankruptcy Code, although three non-exclusive methods of providing adequate protection are suggested. The concept of adequate protection is derived from the

20. Id.
21. 11 U.S.C. § 362(d) (1982 & Supp. II 1984). Unless, after notice and hearing the court orders otherwise, the stay will automatically terminate with respect to the moving party thirty days after a motion to lift stay is filed. 11 U.S.C. § 362(e) (1982 & Supp. II 1984). The Code authorizes an act without a hearing provided appropriate notice is given and no hearing is timely requested by a party in interest. 11 U.S.C. § 102(1) (1982 & Supp. II 1984). Thus, once a motion for relief from stay has been filed, the respondent must take action to prevent the termination of the stay. When a motion for relief from stay is filed in the Bankruptcy Court for the Southern District of Texas, a notice containing the following language must be served on the respondent:

NO HEARING WILL BE CONDUCTED HEREON UNLESS WRITTEN REQUEST FOR HEARING IS FILED WITH THE CLERK OF THE UNITED STATES BANKRUPTCY COURT WITHIN TEN (10) DAYS FROM DATE OF SERVICE HEREOF, UNLESS THE COURT SHORTENS OR EXTENDS THE TIME FOR FILING SUCH REQUEST FOR HEARING.

IF NO HEARING ON SUCH MOTION IS TIMELY REQUESTED, THE MOTION SHALL BE DEEMED TO BE UNOPPOSED, AND THE COURT MAY ENTER AN ORDER GRANTING THE RELIEF SOUGHT.


22. If the creditor seeks relief from the stay of an act against property (such as to enforce a mortgage or privilege), he must show that the debtor does not have an equity in the property and that the property is not necessary for an effective reorganization. 11 U.S.C. § 362(d)(2) (1982 & Supp. II 1984). The debtor does not have an equity in the property when the amount of the creditor's secured claim exceeds the value of the collateral. In Re Royal d'Iberville Corp., 10 Bankr. 37, 39 (Bankr. S.D. Miss. 1981).


24. Id. at 39; "The purpose of this section [§ 361] is to illustrate means by which adequate protection may be provided and to define the limits of the concept." Senate Report, supra note 13, at 5835.


When adequate protection is required under section 362, 363, or 364 of this title of interest of an entity in property, such adequate protection may be provided by—

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use,
protection of property interests established by the fifth amendment to the United States Constitution and from the notion that, while secured creditors should generally not be denied the benefit of their bargain, (that is, the right upon the debtor's default to cause the collateral securing the debt to be sold and to reinvest the proceeds) the policies underlying the Bankruptcy Code would be subverted if the rights of secured creditors were absolute.

The concept of adequate protection has two elements: protection of the value of the secured creditor's interest in the collateral securing the debt and protection of the secured creditor's interest in cash collateral. The Bankruptcy Code suggests two methods of protecting a secured creditor from a decline in value of its collateral. Periodic payments should be made to compensate for depreciation, and, where the collateral might be actually consumed, a replacement lien may be used as an alternative means of realizing the value of the original property serving as collateral.

It is important to note that the Bankruptcy Code speaks of protecting the value of the secured creditor's interest in collateral rather than the value of the collateral itself. In American Mariner Industries, Inc., the Bankruptcy Code suggests two methods of protecting a secured creditor from a decline in value of its collateral. Periodic payments should be made to compensate for depreciation, and, where the collateral might be actually consumed, a replacement lien may be used as an alternative means of realizing the value of the original property serving as collateral. It is important to note that the Bankruptcy Code speaks of protecting the value of the secured creditor's interest in collateral rather than the value of the collateral itself. In American Mariner Industries, Inc., the Bankruptcy Code suggests two methods of protecting a secured creditor from a decline in value of its collateral. Periodic payments should be made to compensate for depreciation, and, where the collateral might be actually consumed, a replacement lien may be used as an alternative means of realizing the value of the original property serving as collateral.

sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than enrolling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.


27. In Re American Mariner Industries, Inc., 734 F.2d 426, 431 (9th Cir. 1984).

28. Senate Report, supra note 13, at 5839: "[Section 361] recognizes the availability of alternate means of protecting a secured creditor's interest where such steps are a necessary part of the rehabilitative process."


32. Senate Report, supra note 13, at 5840.

33. Id. Note that the debtor or the secured creditor must provide or propose a method of protection. The court's function in this regard is merely to determine whether or not the protection provided is adequate. Senate Report, supra note 13, at 5835; In Re Robson, 10 Bankr. 362 (Bankr. N.D. Ala. 1981).


35. In Re American Mariner Indus., Inc., 734 F.2d 426 (9th Cir. 1984). The rationale of this decision has been adopted by at least one other circuit, see, Grudy Nat. Bank v. Tandem Mining Corp., 754 F.2d 1436 (8th Cir. 1985).
Bear Creek Ministorage, Inc.\textsuperscript{36} the courts recognized that the secured creditor's right to foreclose and reinvest the proceeds of foreclosure is also an "interest" in collateral deserving of protection.\textsuperscript{37} In each of these cases had it not been for the filing of the bankruptcy petition, the creditor would have been entitled upon the debtor's default to take possession of the collateral, sell it, and reinvest the proceeds.\textsuperscript{38} Recognizing the "time value" of money, the Bear Creek court held that the secured creditors should be paid interest on the liquidation value of the collateral as compensation for the delay in enforcing their rights caused by the bankruptcy proceeding.\textsuperscript{40}

"Cash collateral" is defined in the Bankruptcy Code as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest.\textsuperscript{41} Specifically included in this definition are the proceeds, products, offspring, rents, or profits of property subject to a security interest.\textsuperscript{42}

The Bankruptcy Code provides that the debtor may not use, sell, or lease cash collateral without the consent of each entity that has an interest in the cash collateral or unless the court, after notice and hearing, authorizes such use, sale, or lease.\textsuperscript{43} In practice, one of the first acts of the debtor after the order for relief has been entered will be to move

\footnotesize{\textsuperscript{36} In Re Bear Creek Ministorage, Inc., 49 Bankr. 454 (Bankr. S.D. Tex. 1985). A companion case to Bear Creek, In Re Timbers of Inwood Forest Assocs., Ltd., 49 Bankr. 454 (Bankr. S.D. Tex 1985), is currently on appeal before the United States Court of Appeal for the Fifth Circuit, In Re Timbers of Inwood Forest Associates, Ltd., d/b/a Timbers of Inwood Forest Apartments, Phase 1, No. 85-2678 (5th Cir.).

\textsuperscript{37} In Re American Mariner Industr., Inc., 734 F.2d 426, 435 (9th Cir. 1984).

\textsuperscript{38} In American Mariner, Crocker National Bank had a perfected security interest in "basically all of American Mariner's assets." It was entitled, under California law, to take possession of the collateral and sell it upon the debtor's default. 734 F.2d at 427-28. Bear Creek involved two creditors, each with similar rights. 49 Bankr. at 456.

\textsuperscript{39} In Re Bear Creek Ministorage, Inc., 49 Bankr. 454 (Bankr. S.D. Tex. 1985).

\textsuperscript{40} Id. at 549. The American Mariner court sanctioned this method of providing adequate protection but stated that it was by no means the only method of providing such protection. 734 F.2d at 435. Note that in Bear Creek the interest payments were to be make from the date that foreclosure might reasonably have been accomplished had there been no bankruptcy (taking into account "prudent foreclosure marketing delay[s]") and the continuation of the automatic stay was conditioned upon such payments being made. 49 Bankr. at 459.


\textsuperscript{42} Id. Note that the reference to proceeds, products, offspring, rents, and profits (added by the 1984 amendments) provides that such are cash collateral if the property is subject to a "security interest." A "security interest" is a lien created by an agreement. 11 U.S.C. § 101(43) (1982 & Supp. II 1984). Thus, the proceeds or rents of property subject to a conventional mortgage would be cash collateral while the proceeds or rents of property subject to a privilege might not.

the court for an order authorizing the use of cash collateral in order to prevent the complete shut-down of his operations. The creditor, of course, will demand adequate protection for his interest in the cash collateral. The court will only sanction the use of cash collateral if the debtor can meet his burden\(^4^4\) of proving that the interest of the secured creditor is adequately protected.\(^4^5\)

**Voidable Transfers And The "Strong Arm Clause"**

The Bankruptcy Code gives the trustee the power to avoid certain prepetition\(^4^6\) transfers deemed preferential\(^4^7\) or fraudulent\(^4^8\) and certain statutory liens.\(^4^9\) In addition, the "strong arm clause"\(^5^0\) enables the trustee to defeat the rights of third parties when those rights have not been properly perfected as of the petition date. Each of these provisions can be significant in an oil and gas bankruptcy.

Section\(^5^1\) 547 provides for the avoidance of preferences by the trustee. Basically, a transfer is preferential and may be avoided if it is: (i) to or for the benefit of a creditor; (ii) on account of an antecedent debt; (iii) made while the debtor is insolvent;\(^5^2\) (iv) made on or within ninety days of the petition date or within one year if the creditor at the time of the transfer was an insider;\(^5^3\) and (v) allows the creditor to receive a greater percentage of his debt than he would receive were the case

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44. The debtor seeking the use of cash collateral has the burden of proving that lienholders are adequately protected. In Re Air Vermont, Inc., 39 Bankr. 684 (Bankr. D. Vt. 1984).
45. 11 U.S.C. § 363(e) (1982 & Supp. II 1984). Such protection might be afforded by the granting of liens on unencumbered assets and by giving the creditor some controls over the debtor’s spending.
51. Unless otherwise indicated, all “section” references are to Title 11 United States Code.
53. “Insider” is defined in 11 U.S.C. § 101(28) (1982 & Supp. II 1984). Exactly who might be considered an “insider” depends upon whether the debtor is an individual, a corporation, or a partnership. The Senate Report explains this section as follows: “An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor.” Senate Report, supra note 13, at 5810.
to proceed to liquidation under chapter 7.\textsuperscript{54} If the transfer is made on or within ninety days of the petition date, the debtor is presumed to be insolvent.\textsuperscript{55} Generally, payments made to a fully secured creditor during the ninety day period preceding the petition date are not preferential.\textsuperscript{56}

The Bankruptcy Code excepts certain transfers made within the preference period from attack by the trustee.\textsuperscript{57} Perhaps the most important of the exceptions are contemporaneous exchanges for new value\textsuperscript{58} and payments made in the ordinary course of business.\textsuperscript{59} Both of these exceptions are necessary if the debtor is to be allowed to operate his business pending the resolution of the case.

Section 548 gives the trustee the power to avoid "fraudulent transfers," a term which includes voluntary or involuntary transfers of the debtor's interest in property made within one year before the petition date either with the intent to hinder, delay, or defraud other creditors or in which the debtor received "less than reasonably equivalent value" when the debtor was insolvent.\textsuperscript{60} While the transfer of assets to a

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\textsuperscript{54} 11 U.S.C. § 547(b) (1982 & Supp. II 1984) provides as follows:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition if such creditor at the time of such transfer was an insider;

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.


\textsuperscript{56} In Re Hale, 15 Bankr. 565 (Bankr. S.D. Ohio 1981). If a creditor is fully secured, upon liquidation he would receive the full amount of his claim.


\textsuperscript{60} 11 U.S.C. § 548(a) (1982 & Supp. II 1984) provides as follows:

(a) The trustee may avoid transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after
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corporation wholly owned, organized, or controlled by the debtor has been called a "badge of fraud," the transfer of property to such a corporation or to a family member, without more, is not necessarily fraudulent. Where fraud has been alleged, actual intent to defraud must be shown.

Section 548 is applicable to foreclosure sales since the statute refers to voluntary or involuntary transfers. Thus, a foreclosure sale wherein the debtor did not receive "reasonably equivalent value" may be avoided by the trustee. The United States Fifth Circuit Court of Appeals, in Durrett v. Washington National Insurance Co., and the cases following it, established a minimum "reasonably equivalent value" which must be received in a foreclosure sale if the transaction is not to be deemed "fraudulent" under section 548. A foreclosure sale within one year before the petition date may be avoided if the property is sold for less than seventy percent of its appraised value. Therefore, care must be

the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

61. In Re Kaiser, 32 Bankr. 701 (Bankr. S.D. N.Y.), aff'd, 722 F.2d 1574 (2d Cir. 1983) (Discharge denied where debtor fraudulently transferred property within one year prior to the petition date.)


63. Id. at 410.

[Section] 548(a)(1) requires a finding of actual fraudulent intent, a purely factual question. However, since § 548(a) is phrased in the disjunctive, a transfer may be avoided if the factors set forth in § 548(a)(2) are shown to have existed. Under this subsection, the intent of the debtor is immaterial; this section imposes a constructive fraud standard. Where the criteria listed in § 548(a)(2) are satisfied, a conclusive presumption of fraud arises.

Id. (citations omitted).

64. See supra note 60.

65. Schafer v. Hammond, 456 F.2d 15 (10th Cir. 1972) (decided under § 67(d)(2) of the former Title 11 United States Code (the "Bankruptcy Act"). This statute is the predecessor statute to § 548(a)(2) of the Bankruptcy Code.).

66. 621 F.2d 201 (5th Cir. 1980) (decided under § 67(d)(2) of the Bankruptcy Act).


taken in structuring a bid at a judicial sale. Where mortgaged property is sold under a writ of *fieri facias* or writ of seizure and sale for two-thirds of its appraised value and a petition in bankruptcy is later filed, the danger exists that the sale might be set aside by the bankruptcy court for failure to meet the *Durrett* test of reasonably equivalent value.

Section 545 provides that the trustee may avoid certain statutory liens. "Liens" are defined in the Code as "charge[s] against or interest[s] in property to secure payment of a debt or performance of an obligation." This definition is broad enough to encompass Louisiana privileges. "Statutory liens" are those liens "arising solely by force of a statute on specified circumstances or conditions, or lien[s] of distress for rent, whether or not statutory, but [do] not include security interest[s] or judicial lien[s]. . ." Questions have been raised as to whether or not the various privileges provided in the Louisiana Civil Code could be "statutory liens" since the Civil Code "is simply a codification of

69. *La. Code Civ. P.* art. 2724 denotes certain provisions of the Code of Civil Procedure relating to the sale under a writ of *fieri facias* which are applicable to the sale of property under a writ of seizure and sale. See infra note 70.

70. *La. Code Civ. P.* art. 2336 provides that where property is first offered for bid in a judicial sale under a writ of *fieri facias* (or under a writ of seizure and sale, see supra note 69) the minimum bid must be at least two-thirds of the appraised value of the property. Hence, the creditor bidding on the property frequently bids two-thirds of appraised value.

71. See *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980).

72. 11 U.S.C. § 545 (1982 & Supp. II 1984) provides as follows:

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien—

(1) first becomes effective against the debtor—

(A) when a case under this title concerning the debtor is commenced;

(B) when an insolvency proceeding other than under this title concerning the debtor is commenced;

(C) when a custodian is appointed or authorized to take or takes possession;

(D) when the debtor becomes insolvent;

(E) when the debtor's financial condition fails to meet a specified standard; or

(F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists;

(3) is for rent; or

(4) is a lien of distress for rent.


what elsewhere is the common law.'"\textsuperscript{76} The better view is that the definition of statutory liens "should be viewed as contemplating all statutes purporting to give preference to a creditor, even the provisions of the Louisiana Civil Code."\textsuperscript{77}

Section 544(a) is the "strong arm clause."\textsuperscript{78} It allows the trustee to assume as of the petition date the guise of a hypothetical judgment creditor, a creditor with an unsatisfied writ of execution, or a \textit{bona fide} purchaser of immovable property from the debtor and allows him to avoid any interest which would be avoidable by any such person.\textsuperscript{79} Thus the trustee may avoid most third parties' interests in property of the estate where such interests are not properly perfected under applicable state law.\textsuperscript{80} Since Louisiana requires recordation in order for most encumbrances to affect third parties, and since the public records doctrine

\begin{itemize}
\item \textsuperscript{76} In Re Hughes, 9 Bankr. 251, 253 (Bankr. W.D. La. 1981).
\item \textsuperscript{78} Senate Report, supra note 13, at 5871.
\item \textsuperscript{79} 11 U.S.C. § 544(a) (1982 & Supp. II 1984) provides as follows:
\begin{enumerate}
\item The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—
\begin{enumerate}
\item a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
\item a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or
\item a \textit{bona fide} purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a \textit{bona fide} purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser and has perfected such transfer exists [sic].
\end{enumerate}
\end{enumerate}
\item \textsuperscript{80} In In Re Vezinot, 20 Bankr. 950 (Bankr. W.D. La. 1982), the trustee was able to avoid a mortgage on immovable property because the property description was insufficient, under Louisiana law, to provide adequate notice to third parties. Thus, the "mortgagee" was left with an unsecured claim. As a practical note, it is critically important not only that a security interest be perfected according to state law, but that such perfection be accomplished before any funds are advanced. The recordation of a mortgage is a "transfer" for purposes of section 547. In Re Airport-81 Nursing Care, Inc., 29 Bankr. 501 (D. E.D. Tenn. 1983). Where, prior to ninety days before the petition date, a mortgage has been granted and funds advanced but the mortgage has not been recorded, later recordation of the mortgage within ninety days of the petition date will constitute a preference and the mortgage may be avoided by the trustee. See id. at 509. The same result obtains when a defective mortgage is filed prior to ninety days of the petition date and an act of correction is filed within ninety days of the petition date.
has established Louisiana as a "pure race state," one can easily imagine the types of interests which may be susceptible to attack by the trustee under the strong arm clause: mortgages, chattel mortgages, assignments of accounts receivable, mortgages of mineral rights, and pledges of mineral production to name but a few.

When a transfer has been avoided by the trustee under one of the provisions discussed above, the trustee may generally recover from the transferee (or the immediate or mediate transferee of the initial transferee) the property transferred or, if the court so orders, its value. A security interest or other interest in property avoided by the trustee is preserved for the benefit of the estate. When a security interest has been avoided under one of the above provisions, the creditor is left with an unsecured claim.

**EXECUTORY CONTRACTS AND UNEXPIRED LEASES**

Section 365 provides that the trustee may, subject to the court's approval, assume or reject any executory contract or unexpired lease of the debtor. Although "executory contract" is not defined in the Code, the legislative history suggests that the term should include those contracts as to which performance remains due to some extent on each side. In connection with oil and gas operations there will normally be obligations to be performed by both the operator and the non-operator[s] under a

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86. See La. R.S. 31:197, 200, 204 (1975).
88. 11 U.S.C. § 551 (1982). In effect, the trustee succeeds to the interest of the mortgage, pledge, etc. "The section as a whole prevents junior lienors from improving their position at the expense of the estate when a senior lien is avoided." Senate Report, supra note 13, at 5877.
90. 11 U.S.C. § 365(a) (1982 & Supp. II 1984). Note that the trustee's power to assume or reject an executory contract is not unbridled. 11 U.S.C. § 365(b) provides that he may not assume a contract or lease unless, at the time of assumption, he cures, or provides adequate assurance that he will promptly cure, any existing default of the debtor; he compensates, or provides adequate assurance that he will compensate, any third party who has suffered a pecuniary loss as a result of the debtor's default; and he provides adequate assurance of future performance under the contract or lease.
91. Senate Report, supra note 13, at 5844.
joint operating agreement at any given point in time. Hence, such an agreement would probably be considered an executory contract in bankruptcy. Similarly, a gas purchase contract would probably be considered an executory contract, at least in instances in which legal title to undelivered gas has not passed and the purchase price has not been paid.

**COMMON ISSUES ARISING IN OIL AND GAS BANKRUPTCIES**

With the foregoing basic concepts in mind, some basic questions which are likely to arise in the context on an oil and gas bankruptcy should be considered. As will be seen, any given transaction may be affected by the application of one or more of such concepts.

As noted above, section 365 allows the trustee to assume or reject any unexpired lease of the debtor. Does this mean that the trustee is free to accept or reject an oil, gas, and mineral lease? If so, he might be able to cancel a mineral lease simply because, in his “business judgement,” a better deal might be found. As in so many other areas of bankruptcy practice, this issue remains unsettled.

In *J. H. Land and Cattle Co.* the court declared that, under Kansas law, an oil and gas lease was an “incorporeal hereditament” which did not create a present vested estate but merely conveyed “a license to enter upon the land and explore for such minerals and if they are discovered to produce and sever them.” In that case the court allowed the debtor to reject eleven oil and gas leases merely because more favorable terms were available elsewhere.

In *In re Myklebust* the court, applying Wisconsin law, declared that a mineral lease is “an interest in land which may be created or

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92. The operator generally has continuing duties under the operating agreement. The non-operators must contribute proportionately to the costs and expenses incident to the operations as billed to them by the operator. See generally, H. Williams & C. Meyers, *Oil and Gas Law* § 503.2, at 570 (1984) (hereinafter cited as Williams & Meyers).


94. Jurisprudence under the Bankruptcy Act had established the “burdensome property test” under which the court would only sanction rejection of an executory contract if continued performance would result in an actual loss to the estate. Under the Code, most courts have applied the “business judgement test” under which assumption or rejection of the contract or lease need only, in the business judgement of the trustee, benefit the estate and its creditors. In *Re Stable Mews Assoc., Inc.*, 41 Bankr. 594 (Bankr. S.D. N.Y. 1984).


97. Id.

98. Id. at 239.

transferred as any other estate in land.100 At issue before the court was whether a mineral lease should be treated as an unexpired lease, as to which the lessee is afforded some protection where the lessor is the debtor,101 or an executory contract. The court apparently failed to consider that it might be neither (which would have been consistent with the court's characterization of the mineral lease under Wisconsin law) and treated it as an unexpired lease which could be assumed or rejected by the debtors.102

Whether or not a mineral lease is an unexpired lease or an executory contract such that it might be accepted or rejected by the trustee must be determined under applicable state law.103 The courts have consistently recognized that common law concepts are inapplicable to Louisiana mineral leases.104 However, the treatment of mineral leases in Louisiana statutes and jurisprudence is a subject of considerable confusion.

In *Guy Scroggins, Inc. v. Emerald Exploration*,105 the court said, ""*m*ineral rights, including mineral leases, are classified under the Mineral Code as incorporeal immovables and are subject to the Civil Code articles respecting immovable property.""106 Later the same circuit, in *St. Romain v. Midas Exploration, Inc.*,107 declared that ""Louisiana mineral leases are construed as leases generally, and, wherever pertinent, the codal provisions applicable to ordinary leases are applied to mineral leases.""108

100. Id. at 584, citing Chicago & N.W. Transp. v. Pedersen, 80 Wis. 2d 566, 259 N.W.2d 316 (1977).
   If the trustee rejects an unexpired lease of real property of the debtor under which the debtor is the lessor, . . . the lessee . . . may treat such lease . . . as terminated by such rejection, . . . or, in the alternative, the lessee . . . may remain in possession of the leasehold . . . for the balance of such term and for any renewal or extension of such term that is enforceable by such lessee . . . under applicable nonbankruptcy law.
104. Mire v. Sunray DX Oil Co., 285 F. Supp. 885 (W.D. La. 1968). ""[I]t is important to keep in mind that the view of the common law of England and of most of the United States, as to the nature of a lease for years, is not that which is taken by the civil law of Rome, Spain, and France, upon which the Civil Code of Louisiana is based."" Id. at 889, quoting Viterbo v. Friedlander, 120 U.S. 707, 7 S. Ct. 962 (1887).
106. Id. at 684. See also, La. R.S. 31:16 (1975); Northcott Expl. Co. v. W.R. Grace & Co., 430 So. 2d 1077 (La. App. 3d Cir. 1983) (Mineral lease gives rise to a real right which may be protected by real actions.).
107. 430 So. 2d 1354 (La. App. 3d Cir. 1983).
108. Id. at 1356 (citations omitted). See also Succession of Rugg, 339 So. 2d 519, 520 (La. App. 2d Cir. 1976) (""[O]il, gas and mineral leases have been traditionally considered nothing more or less under our law than ordinary leases of property. . . ."")
Article 114 of the Louisiana Mineral Code defines a mineral lease as "a contract by which the lessee is granted the right to explore for and produce minerals." The comments to this article indicate that this definition "is intended to be consistent with the concepts embodied in articles 2669 and 2670 of the Civil Code" (dealing with the nature of the contract of lease). However, the same comment refers the reader to article 16 which provides that a mineral lease is a "real right" and declares, "[t]hus, the running controversy between the courts and the legislature as to the nature of the mineral lease is laid to rest by classification of the interest as a real right."

The court was probably correct in its characterization of the Louisiana mineral lease in both Guy Scroggins, Inc. and St. Romain. The mineral lease, as is pointed out in the comments following article 16, is a "hybrid institution" with "the major characteristics of a real right." Unfortunately, however:

The Louisiana concept of a real right is not entirely clear. . . . The Louisiana jurisprudence does not always conform to our legislation on the subject, and the legislation itself is not entirely consistent. It appears that the rights and obligations created by the contract of lease are hybrids, and whether those interests should be treated as personal or real will depend on what rights are being asserted and what obligations are sought to be enforced.

Whether or not the bankruptcy courts will consider Louisiana oil and gas leases as unexpired leases which may be assumed or rejected by the trustee under section 365 has yet to be decided. It is submitted...

109. La. R.S. tit. 31. Unless otherwise indicated, all references to "Article" are to the Mineral Code.
111. La. R.S. 31:114 (1975), comment.
112. Id.
113. La. R.S. 31:16 (1975), comment.
114. Id.
115. Prados v. South Cent. Bell Tel. Co., 329 So. 2d 744, 747 (La. 1976) (footnotes omitted) (not involving a mineral lease). This confusion is not unique to Louisiana law. The nature of the mineral lease is such that it defies easy classification. The tenth circuit describes an Oklahoma mineral lease as follows: "An oil and gas lease under Oklahoma law is a hybrid estate deriving its legal characteristics from both real and personal property, yet it is actually neither. . . . It is personalty . . . and also an interest in land." Carroll v. Holliman, 336 F.2d 425, 429 n.8 (10th Cir. 1964), cert. denied, 380 U.S. 907 (1965), quoting Continental Supply Co. v. Marshall, 152 F.2d 300, 305 (10th Cir. 1945), cert. denied, 327 U.S. 803 (1946) (citations omitted).
that the classification of mineral leases as "real rights" should not be determinative.\textsuperscript{116} Section 365(d)(4) provides:

\begin{quote}
[If the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.]
\end{quote}

Prudent practice would suggest that the trustee or debtor in possession should move to accept all unexpired oil and gas leases under which the debtor is the lessee, or secure an order from the bankruptcy court granting additional time, within sixty days of the entry of the order for relief, in which to do so.

Another question remaining is whether the trustee may, under section 365, assume an oil and gas lease as to which delay rentals were not timely paid by the debtor by "curing" the default and providing adequate assurance of future performance. Again, this is a question yet to be answered in the context of a bankruptcy proceeding. Louisiana courts have held that an oil and gas lease automatically terminates when the lessee fails to pay delay rentals when due.\textsuperscript{117} Thus, where the debtor

\textsuperscript{116} Although La. R.S. 31:16 classifies mineral leases as "real rights," it is not altogether clear just what this classification means. The court considered the predecessor statute to La. R.S. 31:16 in Reagan v. Murphy, 235 La. 529, 105 So. 2d 210, 213 (1958), and found that the legislative purpose, in classifying mineral leases as "real rights" was "not ... to change the essence of the contractual rights and obligations between mineral lessees and lessors but only [to] place mineral lessees on the same level as landowners by conferring on them 'benefits' of the laws relating to owners of immovable property." 235 La. at 539, 105 So. 2d at 213. When the Mineral Code was adopted, article 16 was intended to be "a superficial change from the judicial attitude toward the mineral lease," and the legislature sought to "make it clear that the mineral lease ... is a real right." La. R.S. 31:16 (1975), comment (citing Reagan v. Murphy). The same comment says "[t]he basic purpose of this article is to recognize that insofar as the mineral lease transfers both operating rights and rights to production it is a real right and not a mere personal contract." Even so, a mineral lease does not transfer the ownership of any mineral rights. Instead, it merely grants the mineral lessee the right to explore for and produce minerals. Wall v. Leger, 402 So. 2d 704, 709 (La. App. 1st Cir. 1981). Thus, notwithstanding its classification as a "real right," a Louisiana mineral lease could be viewed by a bankruptcy court as an unexpired lease which might be assumed or rejected by the trustee. See text supra notes 99-102. A different result would probably obtain if Texas law were applied, since the grant of a mineral lease results in an immediate transfer of a determinable fee estate in the minerals in place. Stephens County v. Mid-Kansas Oil & Gas Co., 254 S.W.2d 290 (Tex. 1923); T-Vestco Litt-Vada v. Lu-Cal One Oil Co., 651 S.W.2d 284 (Tex. App—Austin 1983).

has failed to pay delay rentals prior to the filing of the petition, there may be nothing for the trustee to assume, since the lease may have terminated prior to the commencement of the case.\footnote{118}{In Re Autobahn Classics, Inc., 29 Bankr. 625 (Bankr. S.D. N.Y. 1983) "Once a lease [of immovable property] is terminated there remains nothing for a debtor in possession to assume pursuant to Code § 365." Bankruptcy Code § 365(\(c\))(3) provides: "The trustee may not assume or assign any executory contract or unexpired lease of the debtor, . . . if . . . such lease of nonresidential real property has been terminated under applicable nonbankruptcy law prior to the order for relief." See also cases cited supra note 115.}

Whether the automatic stay will prevent the termination of an oil and gas lease for failure to pay delay rentals due after the petition date is another open issue. Obviously, if sufficient "free" cash is available in the debtor's estate, the trustee may pay delay rentals and prevent a lease from terminating.\footnote{119}{Leaving aside questions related to use of cash collateral, the trustee may generally operate the debtor's business unless the court orders otherwise. 11 U.S.C. § 1108 (1982 & Supp. II 1984).} If sufficient funds are not available from the debtor's estate to pay the delay rentals, it is doubtful that the automatic stay will save the lease.\footnote{120}{In Re Trigg, 630 F.2d 1370 (10th Cir. 1980) (decided under the Bankruptcy Act); Good Hope Refineries, Inc. v. Benavides, 602 F.2d 998, 1000 (1st Cir.), cert. denied, 444 U.S. 992 (1979) ("[U]nder the Texas law applicable to this case the lease terminated automatically upon failure to make good tender of delay rental and . . . nothing in the Bankruptcy Act enabled the debtor-in-possession to cure such failure.").}

In instances in which a mineral lease is jointly held, the working interest owners frequently enter into an operating agreement under which one of the working interest owners operates the well[s] for the benefit of the non-operators.\footnote{121}{See generally Williams & Meyers, supra note 92, at § 503.2.} If the operator files for protection under chapter 7 or 11 of the Bankruptcy Code, a furnisher of labor, services, or supplies who has properly filed a notice of claim pursuant to Louisiana Revised Statutes 9:4862 may attempt to enforce his privilege on the proceeds of production attributable to the non-operators.\footnote{122}{La. R.S. 9:4861 (1985) establishes a privilege (hereinafter the "Oil Well Privilege") in favor of those persons who furnish labor, services, or supplies in connection with the drilling of any oil, gas, or water well on, among other things, "all oil or gas produced from the well or wells, and the proceeds thereof inuring to the working interest therein, and on the oil, gas or water well or wells and the lease whereon the same are located." La. R.S. 9:4861 provides for the "perfection" of the privilege by filing a notice of claim within 180 days of the last day labor, services or supplies were furnished. If properly perfected, the privilege relates back to the first day labor, services, or supplies were furnished.} The automatic stay provision of section 362 would not prevent the privilege from being enforced in this manner since it operates in favor of the bankrupt debtor only.\footnote{123}{Pitts v. Unarco Indus., Inc., 698 F.2d 313 (7th Cir. 1983); In Re Autobahn Classics, Inc., 29 Bankr. 625 (Bankr. S.D. N.Y. 1983).}
May the operator withhold proceeds attributable to the interest of a bankrupt non-operator who has failed to pay his share of operating expenses? Operating agreements frequently provide that the operator shall have a lien on the interests of non-operators to secure payment of operating expenses. Even without a contractual lien, the operator should be able to assert the Oil Well Privilege against the non-operator working interest owners. In addition, the operator might have a right of set-off against the non-operator.

Section 542(b) provides that an entity owing a debt that is property of the estate "shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor." Most courts have required that the creditor obtain relief from the automatic stay before exercising a right of set-off. Once relief from the stay has been granted, the operator should be able to offset unpaid joint interest billings against proceeds attributable to the interest of the bankrupt non-operator. In analogous cases, courts have held that an entity with a right of set-off may "retain" funds in its possession pending a determination of the parties' rights. Since the proceeds attributable to the non-operator

124. Williams & Meyers, supra note 92, at § 503.2. Note that the operators lien may not be enforceable in Louisiana unless the formal requisites of a conventional mortgage or some other Louisiana security device are incorporated therein. See La. Civ. Code arts. 3290-3310.


129. Interesting questions arise given Louisiana's unique approach to setoff. La. Civ. Code art. 1893 provides that "[c]ompensation takes place by operation of law." The operation of this article has been described as follows:

In that case [A owes B and B owes A] the law steps in and silently cancels these opposing debts; assent and concurrence of the parties are not necessary; their knowledge of what the law is doing is not required. But this extinguishment takes place only when the debts are equally due, equally liquidated and equally demandable...

Tolbird v. Cooper, 243 La. 306, 315, 143 So. 2d 80, 84 (1962), quoting Saunders' Lectures on the Civil Code of Louisiana (1925). Since, technically, no action on the part of either party is required for compensation to occur, could the argument be advanced that the automatic stay is not applicable in an instance in which the elements of legal compensation are met?

130. In Re Powers, 28 Bankr. 86 (Bankr. E.D. Penn. 1983); In Re Murry, 15 Bankr. 325 (Bankr. E.D. Ark. 1981). Both of these cases involved the right granted by statute to the Internal Revenue Service to setoff amounts owed as a refund against debtor's tax liability.
would likely be deemed cash collateral of the operator, the operator should be able to obtain relief from the stay unless the non-operator proves that the operator will be adequately protected. Thus, the operator should be permitted to retain such funds pending his motion for relief from the automatic stay and, once relief has been granted, should be permitted to set-off against the amounts owing to the non-operator the amount of unpaid joint interest billings. Where funds have already been paid to the non-operator, the operator should be able to insist on adequate protection for the non-operator's use of his cash collateral.

Operating agreements frequently contain a "non-consent provision" whereby working interest owners are put to an election as to the drilling of new wells. Generally, the agreement will provide that the working interest owner who does not consent to the drilling of a new well (and to pay his share of the drilling expenses) will not be entitled to share in the production for the new well until his proportionate part of the costs of drilling plus a penalty have been recovered by the consenting parties. Frequently, the penalty will be substantial, 100 percent to 200 percent of the drilling expense, in order to compensate the participating working interest owners for taking the risk of funding the new well.

An issue might arise as to how the operator and other participating working interest owners may protect their interests when the bankrupt non-operator elects to participate in the new well and it is obvious that he is without funds to pay his share of the expenses. As indicated above, an operating agreement would probably be viewed as an executory contract by a bankruptcy court. Hence, the debtor may be forced to assume or reject the agreement. If he rejects it, the operator may take the position that the debtor has forfeited his right to participate in future wells. If he elects to assume it, he must cure any existing default, which might include failure to pay drilling or operating expenses attributable to existing wells, and provide adequate assurance of his ability to perform under the agreement, i.e., pay his share of the costs of the new well.

Protection of the secured creditor's interest in his collateral or cash collateral during the period between the filing of an involuntary petition
and the granting of an order for relief is another issue which frequently arises. Generally, unless the court orders otherwise, during the “involuntary gap” period between the filing of the involuntary petition and the entry of the order for the relief, the debtor may continue to operate his business and use, acquire, or dispose of property as if the involuntary petition had not been filed.\textsuperscript{36} The legislative history of Bankruptcy Code section 303(f) indicates that the court should be allowed to exercise some control over the debtor “where there is a fear that the debtor may attempt to abscond with assets, dispose of them at less than their fair value, or dismantle his business, all to the detriment of the debtor’s creditors.”\textsuperscript{137} The Code does not specify or even suggest the form such control might take. However, at least one commentator has suggested that when controls on the debtor’s spending are in order pending a hearing on the contested involuntary petition, an application for a temporary restraining order would be appropriate.\textsuperscript{138}

The vendor’s privilege,\textsuperscript{139} the Oil Well Privilege,\textsuperscript{140} and the lessor’s privilege\textsuperscript{141} are particularly important in Louisiana’s statutory scheme of creditor protection. One important issue is whether these statutory liens are avoidable by the trustee under section 545 of the Bankruptcy Code. There is no question as to the voidability of the lessor’s privilege; all liens for rent, whether statutory or not, are expressly made avoidable by section 545(3).\textsuperscript{142} Generally, the vendor’s privilege should survive.\textsuperscript{143} Section 545(2) gives the trustee the status of a hypothetical \textit{bona fide} purchaser and provides that he may avoid a statutory lien if, as of the commencement of the case, a \textit{bona fide} purchaser could have prevailed against the lien-holder. Since the Louisiana vendor’s privilege on movables may only be asserted so long as the property remains in the possession of the purchaser,\textsuperscript{144} the argument has been made, and one

\begin{footnotesize}
\begin{enumerate}
  \item[137.] Senate Report, supra note 13, at 5819.
  \item[138.] L. King, Collier on Bankruptcy § 303.35, at 303-107; See also England v. Doyle, 281 F.2d 304 (9th Cir. 1960) (decided under the Bankruptcy Act, suggesting that injunctive relief would be appropriate in such a situation.).
  \item[140.] La. R.S. 9:4861 (1983).
  \item[141.] La. Civ. Code art. 2705.
  \item[142.] “The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien . . . is for rent . . . .” 11 U.S.C. § 545(3) (1982 & Supp. II 1984).
  \item[143.] In Re Trahan, 283 F. Supp. 620 (W.D. La. 1968), aff’d, 402 F.2d 796 (5th Cir.) (per curiam) cert. denied sub nom, Bernard v. Beneficial Fin. Co., 394 U.S. 930 (1969); In Re Tape City, U.S.A., Inc., 677 F.2d 401 (5th Cir. 1982); In Re Martin Explor. Co., 731 F.2d 1210 (5th Cir. 1984) (vendor’s privilege on immovables avoidable is not properly recorded).
  \item[144.] La. Civ. Code arts. 3217(7), 3227.
\end{enumerate}
\end{footnotesize}
case so held,\textsuperscript{145} that it was avoidable by the trustee. However, the United States Court of Appeals for the Fifth Circuit has consistently held\textsuperscript{146} that section 545 contemplates a \textit{bona fide} purchaser \textit{without} possession and thus the vendor’s privilege on movables may not be avoided by the trustee.\textsuperscript{147}

The Oil Well Privilege may not require recordation in order to affect movable property.\textsuperscript{148} However, if a notice of claim or privilege is filed for record in the parish or parishes in which the leases on which the well-site is located within 180 days after the last labor, services or supplies were furnished, the privilege will prime most other privileges or mortgages which attach to the property after the \textit{first} labor, services, or supplies were furnished.\textsuperscript{149} As to immovable property, the privilege may be lost if not recorded within 180 days after the last labor, services, or supplies were furnished.\textsuperscript{150}

What about the case in which the notice of claim has not been filed at the time that the bankruptcy petition is filed? Generally, if a lien is not \textit{“perfected”} on the petition date, the trustee may be able to avoid it since the automatic stay prevents \textit{“any act to create, perfect, or enforce any lien against property of the estate.”}\textsuperscript{151} Fortunately, the Bankruptcy Code and the jurisprudence provide some relief for the creditor in this situation. Section 546(b) provides a \textit{“savings clause”} which limits the trustee’s avoiding powers where state law would allow a lien to be perfected so that it relates back to an earlier date.\textsuperscript{152} In such a case, the trustee may not avoid the lien since a \textit{bona fide} purchaser who purchased the property on the petition date would take it subject to the later perfected lien.\textsuperscript{153} Moreover, section 362(b)(3) excepts any act to perfect a lien of the type contemplated in

\textsuperscript{145} In Re Hughes, 9 Bankr. 251 (Bankr. W.D. La. 1981).
\textsuperscript{146} In Re Trahan, 283 F. Supp. 620 (W.D. La. 1968), aff’d, 402 F.2d 796 (5th Cir.) (per curiam), cert. denied sub nom, Bernard v. Beneficial Fin. Co., 394 U.S. 930 (1969);
In Re Tape City, U.S.A., Inc., 677 F.2d 401 (5th Cir. 1982).
\textsuperscript{148} The federal courts have held that recordation is not necessary to preserve the privilege on movables but merely serves to preserve its ranking as against other encumbrances. See Ogden Oil Co. v. Servco, Inc., 611 F. Supp. 572, 575 (M.D. La. 1985) and the cases cited therein.
\textsuperscript{149} La. R.S. 9:4862 (1983). The privilege will not prime a lien for taxes or a vendor’s lien.
\textsuperscript{152} “The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection. . . . .” 11 U.S.C. § 546(b) (1982 & Supp. II 1984).
\textsuperscript{153} Senate Report, supra note 13, at 5871.
section 546(b) from the effect of the automatic stay. Thus, it has been held that the filing of a mechanic’s lien which, when perfected, would relate back to the commencement of work under the contract, and therefore does not violate the automatic stay.\textsuperscript{154} It seems clear that the furnisher of labor, services, or supplies to an oil or gas well in Louisiana should be able to file his notice of claim after the petition date and be confident that his privilege would withstand attack by the trustee under section 545.

Problems frequently arise where farm-out agreements are involved. Under such an agreement, the owner of a mineral lease may agree to assign an interest in the lease to another party who agrees to drill a well.\textsuperscript{155} Frequently, an assignment is not made until the well is completed.\textsuperscript{156} Whether such an agreement is an executory contract that may be assumed or rejected by the trustee has yet to be decided. However, the answer to this question would depend upon the extent to which there are duties to be performed by each party. One commonly cited definition of an executory contract is “a contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.”\textsuperscript{157} Thus, the contract is executory where the obligations of both parties remain substantially unperformed.\textsuperscript{158} Where the non-bankrupt party has fully performed but the bankrupt has performed only partially or not at all, the contract would probably not be executory and the trustee would not have the option to assume or reject it.\textsuperscript{159} In any given case, the probability that the trustee would have the power to assume or reject a farm-out agreement might be predicted by reference to a continuum with no performance by either party at one end and full performance by the non-bankrupt party at the other. Where the non-bankrupt farmee had not begun drilling the well, the trustee could probably reject the agreement. Where the well had been drilled and all of the other obligations of the farmee had been performed but the

\begin{thebibliography}{9}
\bibitem{cantrup} In Re Cantrup, 38 Bankr. 148 (Bankr. D. Colo. 1984); see also In Re Hamlin, 34 Bankr. 673 (Bankr. E.D. Mich. 1983) (mechanic’s construction lien).
\bibitem{aguillard} Id.
\bibitem{jenson} Jenson v. Continental Fin. Corp., 591 F.2d 477, 481 (8th Cir. 1979), quoting Countryman, Executory Contracts in Bankruptcy: Part II, 57 Minn. L. Rev. 439, 460 (1973). Whether or not a contract is executory under bankruptcy law is an issue of federal law. However, the legal consequences of a failure to perform obligations due under the contract is a question of state law. In Re Cochise College Park, Inc., 703 F.2d 1339, 1348 n.4 (9th Cir. 1983).
\bibitem{jenson2} Jenson, 591 F.2d at 481.
\bibitem{knutson} See In Re Knutson, 563 F.2d 916 (8th Cir. 1977) (decided under the Bankruptcy Act).
\end{thebibliography}
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farmer had not yet assigned the farmee his interest, the trustee probably could not refuse to execute the assignment under the guise of rejecting an executory contract.

Another open issue is whether the farmee's investors have any rights cognizable in bankruptcy. Frequently a farmee will be without the means to drill the required well[s] on his own so he will seek investors who, in return for their investment, will receive the farmee's promise to assign them an interest in the well after his interest has been earned. All too often the farmee will be forced into bankruptcy before he can complete his drilling obligations or before he has assigned interests in the well[s] to the various participants. Remember that the trustee or debtor in possession can avoid interests which might be cut-off by a bona fide purchaser.

Since the investors have no interest of record, the trustee should be able to defeat their interests. Of course, a farmee in this situation may be reluctant to bring an avoidance action against his investors if he hopes to have any post-bankruptcy future in the industry. In such a case, where the debtor refuses to bring an avoidance action, the creditor's committee may be allowed to bring it on his behalf. Thus, there is every chance that the investors may be relegated to the status of unsecured creditors of the estate.

CONCLUSION

A myriad of specialized issues exist in the context of a bankruptcy involving oil and gas operations and undoubtedly many questions will arise for which there are no easy answers. Unfortunately, the limits of time and space prevent the discussion of all of them. It is hoped that this article will serve to put the non-bankruptcy practitioner on notice of some of the more common pitfalls to be avoided.

160. See In Re Rojas, 10 Bankr. 353 (Bankr. App. 9th Cir. 1981).
162. In Re Toledo Equip. Co., 35 Bankr. 315, 319 (Bankr. N.D. Ohio 1983) ("[I]t is well established that the provisions of 11 U.S.C. § 1103(c)(5) and 1109(b) impliedly authorize a creditor's committee to bring an action if, in its discretion, it would benefit the estate, and if the debtor-in-possession has unjustifiably failed to prosecute the case."); accord In Re Evergreen Valley Resort, Inc., 27 Bankr. 75 (Bankr. D. Maine 1983).
163. There are indications that the courts might be willing to fashion some relief for the investor in this predicament. In Boyd v. Martin Exploration Co., 56 Bank. 776 (E.D. La. 1986), former management personnel of the debtor sued to compel the formal transfer of certain overriding royalty interests which had been promised them in letter agreements executed at the time of their employment. Some of the disputed interests had been transferred to a nominee while title to others remained in the debtor. The court held that the nominee and the debtor held only bare legal title to the interests and imposed a constructive trust for the benefit of the former employees and ordered that the property be turned over to the true owners.