

## HOUSE BILL No. 2382

By Committee on Judiciary

2-14

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AN ACT concerning the uniform commercial code; concerning securities interests in oil and gas production; amending K.S.A. 2002 Supp. 84-9-324 and repealing the existing section.

*Be it enacted by the Legislature of the State of Kansas:*

New Section 1. (1) 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. A signed writing giving the interest owner a right under real estate law operates as a security agreement created under article 9 of chapter 84 of the Kansas Statutes Annotated, and amendments thereto. 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 and adoption of the security agreement in accordance with K.S.A. 84-1-201(39), and amendments thereto.

(2) 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 writing recorded in the real estate records of a register of deeds, that writing is effective as a filed financing statement for purposes of K.S.A. 2002 Supp. 84-9-309, 84-9-310, 84-9-311, 84-9-312, 84-9-315, 84-9-322, 84-9-323, 84-9-324, 84-9-501, 84-9-502, 84-9-503, 84-9-504, 84-9-506, 84-9-507, 84-9-512, 84-9-515, 84-9-516, 84-9-519, 84-9-521, 84-9-522 and 84-9-525, and amendments thereto, but no fee is required except that otherwise required by the register of deeds, and there is no requirement of refiling every five years to maintain effectiveness of the filing.

(3) The security interest exists in oil and gas production, and also in the following proceeds of such production owned by, received by, or due to the first purchaser:

(a) For an unlimited time if:

(i) The proceeds are oil or gas production, inventory of raw, refined or manufactured oil or gas production, or rights to or products of any of

1 these, although the sale of such proceeds by a first purchaser to a buyer  
2 in the ordinary course of business as provided in subsection (5) will cut  
3 off the security interest in those proceeds;

4 (ii) the proceeds are accounts, chattel paper, instruments and docu-  
5 ments; or

6 (iii) the proceeds are cash proceeds; and

7 (b) for the length of time provided by K.S.A. 2002 Supp. 84-9-315,  
8 and amendments thereto, as to all other proceeds.

9 (4) This section creates a lien that secures the payment of all taxes  
10 that are or should be withheld or paid by the first purchaser, and a lien  
11 that secures the rights of any person who would be entitled to a security  
12 interest under subsection (a)(i) of this section except for lack of any adop-  
13 tion of a security agreement by the first purchaser or a lack of possession  
14 or writing required by K.S.A. 2002 Supp. 84-9-201 or 84-9-203, and  
15 amendments thereto, for the security interest to be enforceable.

16 (5) The security interests and liens created by this section have pri-  
17 ority over bona fide purchasers (transferees in bulk and other buyers not  
18 in the ordinary course), but are cut off by the sale to a buyer from the  
19 first purchaser in the ordinary course of the first purchaser's business  
20 under K.S.A. 2002 Supp. 84-9-320, and amendments thereto, but in ei-  
21 ther case, whether or not the buyer from the first purchaser is in the  
22 ordinary course, a security interest will continue in the proceeds of the  
23 sale by the first purchaser as provided in subsection (3).

24 (6) The security interest and all liens created by this section will have  
25 the following priorities over other article 9 security interests:

26 (a) Security interests created by this section shall be treated as pur-  
27 chase money security interests for purposes of determining their relative  
28 priority under K.S.A. 2002 Supp. 84-9-322, 84-9-323 or 84-9-324, and  
29 amendments thereto, over other security interests not provided for by  
30 this section; holders of these security interests are not required to give  
31 the written notices as provided by K.S.A. 2002 Supp. 84-9-324, and  
32 amendments thereto, to enjoy purchase money priority over security in-  
33 terests with a prior financing statement covering inventory; and

34 (b) statutory liens are subordinate to all other perfected article se-  
35 curity interests, and have priority over unperfected article security inter-  
36 ests and the lien creditors, buyers and transferees mentioned in K.S.A.  
37 2002 Supp. 84-9-317 or 84-9-323, and amendments thereto.

38 (7) The security interests and liens created by this section have the  
39 following priorities among themselves:

40 (a) If a writing effective as a financing statement under subsection  
41 (2) of this section exists, the security interests perfected by that writing  
42 have priority over a security interest automatically perfected without filing  
43 under subsection (2) of this section. If several security interests perfected

1 by writings exist, they have the same priority among themselves as estab-  
2 lished by real estate law for interests in oil and gas in place. If real estate  
3 law establishes no priority among them, they share priority pro rata;

4 (b) a security interest perfected automatically without filing under  
5 subsection (2) of this section has priority over a lien created under sub-  
6 section (4) of this section; and

7 (c) a nontax lien under subsection (4) of this section has priority over  
8 a lien created under that subsection that secures the payment of taxes.

9 (8) The priorities for statutory liens mentioned in K.S.A. 2002 Supp.  
10 84-9-333, and amendments thereto, do not apply to any security interest  
11 or statutory lien created by this section. But if any pipeline common  
12 carrier has a statutory or tariff lien which is effective and enforceable  
13 against a trustee in bankruptcy and not invalidated by the federal tax lien  
14 act, it will have priority over the security interests and statutory liens  
15 created by this section.

16 (9) If oil or gas production in which there are security interests or  
17 statutory liens created by this section is commingled with inventory or  
18 other production, the rules of K.S.A. 2002 Supp. 84-9-336, and amend-  
19 ments thereto, apply.

20 (10) A security interest or statutory lien created by this section re-  
21 mains effective against the debtor and perfected against the debtor's cred-  
22 itors even if assigned, regardless of whether the assignment is perfected  
23 against the assignor's creditors. If a deed, mineral deed, assignment of oil  
24 or gas lease, or other such writing evidencing the assignment is filed in  
25 the real estate records of the county, it will have the same effect as filing  
26 an amended financing statement under K.S.A. 2002 Supp. 84-9-515, and  
27 amendments thereto.

28 (11) This section does not impair an operator's right to setoff or with-  
29 hold funds from other interest owners as security for or in satisfaction of  
30 any debt or security interest. In case of a dispute between an operator  
31 and another interest owner, a good faith tender by anyone of funds to the  
32 person they shall agree on or who may otherwise be shown to be the one  
33 entitled to the funds or to a court of competent jurisdiction in the event  
34 of litigation or bankruptcy, shall operate as a tender of the funds to both.

35 (12) A first purchaser who acts in good faith may terminate an interest  
36 owner's security interest or statutory lien under this section by paying, or  
37 by making and keeping open a tender of the amount the first purchaser  
38 believes to be due to the interest owner:

39 (a) If the interest owner's rights are to oil or gas production or its  
40 proceeds, either to the operator alone, in which case the operator shall  
41 be considered the first purchaser, or to some combination of the interest  
42 owner and the operator, as the first purchaser chooses;

43 (b) whatever the nature of the production to which the interest owner

1 has rights, to the person that the interest owner agreed to or acquiesced  
2 in; or

3 (c) to a court of competent jurisdiction in the event of litigation or  
4 bankruptcy.

5 (13) A person who buys from a first purchaser can assure that such  
6 person buys free and clear of an interest owner's security interest or  
7 statutory lien under this section:

8 (a) By buying in the ordinary course of the first purchaser's business  
9 from the first purchaser under K.S.A. 2002 Supp. 84-9-320, and amend-  
10 ments thereto;

11 (b) by obtaining the interest owner's consent to the sale under K.S.A.  
12 2002 Supp. 84-9-315 and amendments thereto;

13 (c) by insuring that the first purchaser has paid the interest owner,  
14 or else, provided that gas production is involved, or the interest owner  
15 has so agreed or acquiesced, by insuring that the first purchaser has paid  
16 the interest owner's operator; or

17 (d) by insuring that such person or the first purchaser or some other  
18 person has withheld funds sufficient to pay amounts in dispute and has  
19 maintained a tender of such funds to whoever may be shown to be the  
20 person entitled. If a tender which is valid thereafter fails, the security  
21 interest and liens governed by this section remain effective.

22 (14) Nothing contained herein shall be construed to impair or affect  
23 the remedies available at law or in equity to the holders of security in-  
24 terests and liens created by this section.

25 (15) The rights of any person claiming under a security interest or  
26 lien created by this section are governed by the other provisions of this  
27 chapter except to the extent that this section necessarily displaces those  
28 provisions. This section does not invalidate or otherwise affect the inter-  
29 ests of any person in any real property prior to severance of any oil or gas  
30 production.

31 (16) In this section:

32 (a) "Oil and gas production" means any oil, natural gas, condensate  
33 or either, natural gas liquids, other gaseous, liquid or dissolved hydrocar-  
34 bons, sulfur, or helium, or other substance produced as a by-product or  
35 adjunct to their production, or any combination of these, which is severed,  
36 extracted or produced from the ground within the jurisdiction of the state  
37 of Kansas. Any such substance, including recoverable or recovered natural  
38 gas liquids, which is transported to or in a natural gas pipeline or natural  
39 gas gathering system, or otherwise transported or sold for use as natural  
40 gas, or is transported or sold for the extraction of helium or natural gas  
41 liquids is "gas production." Any such substance which is transported or  
42 sold to persons and for purposes not included in the foregoing natural  
43 gas definition is oil production.

1 (b) “Interest owner” means a person owning an entire or fractional  
2 interest of any kind or nature in oil or gas production at the time of  
3 severance, or a person who has an express, implied or constructive right  
4 to receive a monetary payment determined by the value of oil or gas  
5 production or by the amount of production.

6 (c) “First purchaser” means the first person that purchases oil or gas  
7 production from an operator or interest owner after the production is  
8 severed, or an operator that received production proceeds from a third-  
9 party purchaser who acts in good faith under a division order or other  
10 agreement signed by the operator under which the operator collects pro-  
11 ceeds of production on behalf of other interest owners. To the extent the  
12 operator receives proceeds attributable to the interest of other interest  
13 owners from a third-party purchaser who acts in good faith under a di-  
14 vision order or other agreement signed by such operator the operator  
15 shall be considered to be the first purchaser of the production for all  
16 purposes under this section, notwithstanding the characterization of other  
17 persons as first purchasers under other laws or regulations. To the extent  
18 the operator has not received from the third-party purchaser proceeds  
19 attributable to the operator’s interest and the interest of other interest  
20 owners, the operator is not considered the first purchaser for the purposes  
21 of this section, and is entitled to all rights and benefits under this section.  
22 Nothing herein shall impair or affect any rights otherwise held by a royalty  
23 owner to take its share of oil or gas in kind or receive payment directly  
24 from a third-party purchaser for such royalty owner’s share of oil or gas  
25 production with or without a previously made agreement.

26 (d) “Operator” means a person engaged in the business of severing  
27 oil and or gas production from the ground, whether for the operator  
28 alone, for other persons alone or for the operator and others.

29 (e) “Division order” means a document executed by an interest  
30 owner that acknowledges the accuracy of the name and address of that  
31 interest owner, its tax identification number, and the quantum and type  
32 of interest of such interest owner relating to the property described in  
33 the document. To the extent a division order purports to alter or amend  
34 the applicable oil or gas lease, including its express and implied covenants,  
35 the terms of such oil or gas lease shall prevail.

36 Sec. 2. K.S.A. 2002 Supp. 84-9-324 is hereby amended to read as  
37 follows: 84-9-324. (a) **General rule: purchase-money priority.** Except  
38 as otherwise provided in subsection (g), a perfected purchase-money se-  
39 curity interest in goods other than inventory or livestock has priority over  
40 a conflicting security interest in the same goods, and, except as otherwise  
41 provided in K.S.A. 2002 Supp. 84-9-327 and amendments thereto, a per-  
42 fected security interest in its identifiable proceeds also has priority, if the  
43 purchase-money security interest is perfected when the debtor receives

1 possession of the collateral or within 20 days thereafter.

2 (b) **Inventory purchase-money priority.** Subject to subsection (c)  
3 and except as otherwise provided in subsection (g), a perfected purchase-  
4 money security interest in inventory has priority over a conflicting security  
5 interest in the same inventory, has priority over a conflicting security  
6 interest in chattel paper or an instrument constituting proceeds of the  
7 inventory and in proceeds of the chattel paper, if so provided in K.S.A.  
8 2002 Supp. 84-9-330 and amendments thereto, and, except as otherwise  
9 provided in K.S.A. 2002 Supp. 84-9-327 and amendments thereto, also  
10 has priority in identifiable cash proceeds of the inventory to the extent  
11 the identifiable cash proceeds are received on or before the delivery of  
12 the inventory to a buyer, if:

13 (1) The purchase-money security interest is perfected when the  
14 debtor receives possession of the inventory;

15 (2) *except where excused by section 1, and amendments thereto*, the  
16 purchase-money secured party sends an authenticated notification to the  
17 holder of the conflicting security interest;

18 (3) the holder of the conflicting security interest receives the notifi-  
19 cation within five years before the debtor receives possession of the in-  
20 ventory; and

21 (4) the notification states that the person sending the notification has  
22 or expects to acquire a purchase-money security interest in inventory of  
23 the debtor and describes the inventory.

24 (c) **Holders of conflicting inventory security interests to be no-**  
25 **tified.** Subsections (b)(2) through (4) apply only if the holder of the con-  
26 flicting security interest had filed a financing statement covering the same  
27 types of inventory:

28 (1) If the purchase-money security interest is perfected by filing, be-  
29 fore the date of the filing; or

30 (2) if the purchase-money security interest is temporarily perfected  
31 without filing or possession under K.S.A. 2002 Supp. 84-9-312(f) and  
32 amendments thereto, before the beginning of the 20-day period  
33 thereunder.

34 (d) **Livestock purchase-money priority.** Subject to subsection (e)  
35 and except as otherwise provided in subsection (g), a perfected purchase-  
36 money security interest in livestock that are farm products has priority  
37 over a conflicting security interest in the same livestock, and, except as  
38 otherwise provided in K.S.A. 2002 Supp. 84-9-327 and amendments  
39 thereto, a perfected security interest in their identifiable proceeds and  
40 identifiable products in their unmanufactured states also has priority, if:

41 (1) The purchase-money security interest is perfected when the  
42 debtor receives possession of the livestock;

43 (2) the purchase-money secured party sends an authenticated noti-

1 fication to the holder of the conflicting security interest;

2 (3) the holder of the conflicting security interest receives the notifi-  
3 cation within six months before the debtor receives possession of the  
4 livestock; and

5 (4) the notification states that the person sending the notification has  
6 or expects to acquire a purchase-money security interest in livestock of  
7 the debtor and describes the livestock.

8 (e) **Holders of conflicting livestock security interests to be no-**  
9 **tified.** Subsections (d)(2) through (4) apply only if the holder of the con-  
10 flicting security interest had filed a financing statement covering the same  
11 types of livestock:

12 (1) If the purchase-money security interest is perfected by filing, be-  
13 fore the date of the filing; or

14 (2) if the purchase-money security interest is temporarily perfected  
15 without filing or possession under K.S.A. 2002 Supp. 84-9-312(f) and  
16 amendments thereto, before the beginning of the 20-day period  
17 thereunder.

18 (f) **Software purchase-money priority.** Except as otherwise pro-  
19 vided in subsection (g), a perfected purchase-money security interest in  
20 software has priority over a conflicting security interest in the same col-  
21 lateral, and, except as otherwise provided in K.S.A. 2002 Supp. 84-9-327  
22 and amendments thereto, a perfected security interest in its identifiable  
23 proceeds also has priority, to the extent that the purchase-money security  
24 interest in the goods in which the software was acquired for use has  
25 priority in the goods and proceeds of the goods under this section.

26 (g) **Conflicting purchase-money security interests.** If more than  
27 one security interest qualifies for priority in the same collateral under  
28 subsection (a), (b), (d), or (f):

29 (1) A security interest securing an obligation incurred as all or part  
30 of the price of the collateral has priority over a security interest securing  
31 an obligation incurred for value given to enable the debtor to acquire  
32 rights in or the use of collateral; and

33 (2) in all other cases, K.S.A. 2002 Supp. 84-9-322(a) and amendments  
34 thereto applies to the qualifying security interests.

35 Sec. 3. K.S.A. 2002 Supp. 84-9-324 is hereby repealed.

36 Sec. 4. This act shall take effect and be in force from and after its  
37 publication in the statute book.

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