

HOUSE BILL No. 2104

AN ACT concerning the uniform commercial code; concerning securities interests in oil and gas production; amending K.S.A. 2005 Supp. 84-9-324 and repealing the existing section.

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

New Section 1. (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. 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.

(b) In order for any interest owner to claim the security interest provided by this section, an affidavit of production must be filed as prescribed by K.S.A. 55-205, and amendments thereto, which affidavit must show that a well or wells capable of producing in paying quantities have been completed on the pertinent oil and gas lease or leases and lands covered thereby. This filing is effective as a financing statement covering as-extracted collateral as provided by K.S.A. 2005 Supp. 84-9-501, and amendments thereto, and the security interest provided by this section is perfected as of the date of recording. There is no requirement of refiled every five years to maintain the effectiveness of the filing.

(c) 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:

(1) For an unlimited time if:

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

(B) the proceeds are accounts, chattel paper, instruments and documents; or

(C) the proceeds are cash proceeds; and

(2) for the length of time provided by K.S.A. 2005 Supp. 84-9-315, and amendments thereto, as to all other proceeds.

(d) This section creates a lien that secures the payment of all taxes that are or should be withheld or paid by the first purchaser, and a lien that secures the rights of any person who would be entitled to a security interest under subsection (c)(1)(A) of this section except for lack of any adoption of a security agreement by the first purchaser or a lack of possession or writing required by K.S.A. 2005 Supp. 84-9-201 or 84-9-203, and amendments thereto, for the security interest to be enforceable.

(e) The security interests and liens created by this section have priority over bona fide purchasers (transferees in bulk and other buyers not in the ordinary course), but are cut off by the sale to a buyer from the first purchaser in the ordinary course of the first purchaser's business under K.S.A. 2005 Supp. 84-9-320, and amendments thereto, but in either case, whether or not the buyer from the first purchaser is in the ordinary course, a security interest will continue in the proceeds of the sale by the first purchaser as provided in subsection (3).

(f) The security interest and all liens created by this section will have the following priorities:

(1) Security interests created by this section shall be treated as purchase money security interests for purposes of determining their relative priority under K.S.A. 2005 Supp. 84-9-322, 84-9-323 or 84-9-324, and amendments thereto; holders of these security interests are not required to give the written notices as provided by K.S.A. 2005 Supp. 84-9-324, and amendments thereto, to enjoy purchase money priority over security interests with a prior financing statement covering inventory; and

(2) statutory liens created by this section are subordinate to all other perfected article 9 security interests, and have priority over unperfected article 9 security interests and the lien creditors, buyers and transferees

mentioned in K.S.A. 2005 Supp. 84-9-317 or 84-9-323, and amendments thereto.

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

(1) If a writing effective as a financing statement under subsection (b) of this section exists, the security interests perfected by that writing have priority over a security interest automatically perfected without filing under subsection (b) of this section. If several security interests perfected by writings exist, they have the same priority among themselves as established by real estate law for interests in oil and gas in place. If real estate law establishes no priority among them, they share priority pro rata;

(2) a security interest perfected automatically without filing under subsection (b) of this section has priority over a lien created under subsection (d) of this section; and

(3) a nontax lien under subsection (d) of this section has priority over a lien created under that subsection that secures the payment of taxes.

(h) The statutory lien created by this section shall not be considered a “possessory lien” as defined by K.S.A. 2005 Supp. 84-9-333, and amendments thereto. The provisions of K.S.A. 2005 Supp. 84-9-333, and amendments thereto, shall not apply to the statutory lien created by this section. However, if any pipeline common carrier has a statutory or tariff lien which is effective and enforceable against a trustee in bankruptcy and not invalidated by the federal tax lien act, it will have priority over the security interests and statutory liens created by this section.

(i) If oil or gas production in which there are security interests or statutory liens created by this section is commingled with inventory or other production, the rules of K.S.A. 2005 Supp. 84-9-336, and amendments thereto, apply.

(j) A security interest or statutory lien created by this section remains effective against the debtor and perfected against the debtor’s creditors even if assigned, regardless of whether the assignment is perfected against the assignor’s creditors. If a deed, mineral deed, assignment of oil or gas lease, or other such writing evidencing the assignment is filed in the real estate records of the county, it will have the same effect as filing an amended financing statement under K.S.A. 2005 Supp. 84-9-515, and amendments thereto.

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

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

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

(2) whatever the nature of the production to which the interest owner has rights, to the person that the interest owner agreed to or acquiesced in; or

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

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

(1) By buying in the ordinary course of the first purchaser’s business from the first purchaser under K.S.A. 2005 Supp. 84-9-320, and amendments thereto;

(2) by obtaining the interest owner’s consent to the sale under K.S.A. 2005 Supp. 84-9-315 and amendments thereto;

(3) by insuring that the first purchaser has paid the interest owner, or else, provided that gas production is involved, or the interest owner has so agreed or acquiesced, by insuring that the first purchaser has paid the interest owner’s operator; or

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

(n) Nothing contained herein shall be construed to impair or affect the remedies available at law or in equity to the holders of security interests and liens created by this section.

(o) The rights of any person claiming under a security interest or lien created by this section are governed by the other provisions of this chapter except to the extent that this section necessarily displaces those provisions. This section does not invalidate or otherwise affect the interests of any person in any real property prior to severance of any oil or gas production.

(p) In this section:

(1) “Oil and gas production” means any oil, natural gas, condensate or ether, natural gas liquids, other gaseous, liquid or dissolved hydrocarbons, sulfur, or helium, or other substance produced as a by-product or adjunct to their production, or any combination of these, which is severed, extracted or produced from the ground within the jurisdiction of the state of Kansas. Any such substance, including recoverable or recovered natural gas liquids, which is transported to or in a natural gas pipeline or natural gas gathering system, or otherwise transported or sold for use as natural gas, or is transported or sold for the extraction of helium or natural gas liquids is “gas production.” Any such substance which is transported or sold to persons and for purposes not included in the foregoing natural gas definition is oil production.

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

(3) “First purchaser” means the first person that purchases oil or gas production from an operator or interest owner after the production is severed, or an operator that received production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement signed by the operator under which the operator collects proceeds of production on behalf of other interest owners. To the extent the operator receives proceeds attributable to the interest of other interest owners from a third-party purchaser who acts in good faith under a division order or other agreement signed by such operator the operator shall be considered to be the first purchaser of the production for all purposes under this section, notwithstanding the characterization of other persons as first purchasers under other laws or regulations. To the extent the operator has not received from the third-party purchaser proceeds attributable to the operator’s interest and the interest of other interest owners, the operator is not considered the first purchaser for the purposes of this section, and is entitled to all rights and benefits under this section. Nothing herein shall impair or affect any rights otherwise held by a royalty owner to take its share of oil or gas in kind or receive payment directly from a third-party purchaser for such royalty owner’s share of oil or gas production with or without a previously made agreement.

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

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

Sec. 2. K.S.A. 2005 Supp. 84-9-324 is hereby amended to read as follows: 84-9-324. (a) **General rule: purchase-money priority.** Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in K.S.A. 2005 Supp. 84-9-327 and amendments thereto, a per-

fectured security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

(b) **Inventory purchase-money priority.** Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in K.S.A. 2005 Supp. 84-9-330 and amendments thereto, and, except as otherwise provided in K.S.A. 2005 Supp. 84-9-327 and amendments thereto, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

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

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

(3) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

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

(c) **Holders of conflicting inventory security interests to be notified.** Subsections (b)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:

(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under K.S.A. 2005 Supp. 84-9-312(f) and amendments thereto, before the beginning of the 20-day period thereunder.

(d) **Livestock purchase-money priority.** Subject to subsection (e) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in K.S.A. 2005 Supp. 84-9-327 and amendments thereto, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority, if:

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

(2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) the holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and

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

(e) **Holders of conflicting livestock security interests to be notified.** Subsections (d)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:

(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under K.S.A. 2005 Supp. 84-9-312(f) and amendments thereto, before the beginning of the 20-day period thereunder.

(f) **Software purchase-money priority.** Except as otherwise provided in subsection (g), a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in K.S.A. 2005 Supp. 84-9-327 and amendments thereto, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security

interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

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

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

(2) in all other cases, K.S.A. 2005 Supp. 84-9-322(a) and amendments thereto applies to the qualifying security interests.

Sec. 3. K.S.A. 2005 Supp. 84-9-324 is hereby repealed.

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

I hereby certify that the above BILL originated in the HOUSE, and passed that body

HOUSE adopted
Conference Committee Report _____

Speaker of the House.

Chief Clerk of the House.

Passed the SENATE
as amended _____

SENATE adopted
Conference Committee Report _____

President of the Senate.

Secretary of the Senate.

APPROVED _____

Governor.