Creditor Lien Rights in Oklahoma and the Impact of Bankruptcy

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CREDITOR LIEN RIGHTS IN OKLAHOMA AND THE IMPACT OF BANKRUPTCY

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I. THE NATURE OF COMPETING CLAIMS — SECURED AND UNSECURED CREDITORS

An unsecured creditor has no right of recourse against assets of a debtor until steps have been taken to secure a lien. A lien is a charge imposed upon specific property of the debtor, making that property security for payment of the debt.¹ A lien can be created by a contract between the parties or by operation of law.² Generally, different liens on the same property have priority according to the time of their creation or perfection.³ This can be described as a “first-in-time, first-in-right”

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priority system. This basic principle, however, is subject to a number of exceptions, which can complicate priority problems. As a consequence, understanding secured creditor priorities is largely a matter of understanding the exceptions to the "first-in-time rule." This in turn requires a thorough understanding of the types and characteristics of the various players — the secured claimants. These will be identified briefly and then described more fully, along with their priorities and some discussion of bankruptcy, in sections II through XI. Sections XII through XV will then concentrate on reviewing the impact of bankruptcy on this priority system. Prejudgment attachment and postjudgment garnishment liens have not been covered because of unique constitutional considerations outside the scope of this article.4

The easiest to understand is the status of the voluntary secured creditor, the holder of a consensual encumbrance of the debtor's property given to secure a debt. This encumbrance may be a real estate mortgage, creating a mortgage lien.5 If the collateral is personal property it may be a security interest, governed by article 9 of the Uniform Commercial Code.6 If the collateral is personal property affixed to realty, there may be a special encumbrance known as a fixture security interest.7 Future advances, proceeds, and after-acquired property suggest other special problems.8

Non-consensual liens are somewhat more convoluted. These include judicial liens, such as judgment liens, execution liens, attachment liens, and lis pendens. In addition there are statutory and common law liens for work done on or to the property. These include, for example, mechanics' and materialmen's liens, artisan's liens, repairman's liens, and ware-


houseman's liens. Of these and other common law and statutory liens such as landlord's liens, agister's (feedman's) liens, and vendor's liens, all except mechanics' and materialmen's liens may require possession by the lienor. Tax liens are another type of special lien. There may also be equitable liens and claims, such as the equitable mortgage,\(^9\) equitable lien, and a surety's equitable right of subrogation.\(^{10}\)

Bankruptcy liens, the avoidance powers of the trustee or debtor-in-possession, and the limitations on these avoidance powers become a factor upon debtor insolvency. These include the trustee as lien creditor,\(^{11}\) trustee's avoidance of fraudulent transfers,\(^{12}\) trustee's avoidance of statutory liens,\(^{13}\) trustee's avoidance of preferential transfers,\(^{14}\) and the treatment of tax liens in Chapter 7.\(^{15}\) These may result in priorities in bankruptcy that differ from state law priorities, including the possibility that a creditor's claim could be equitably subrogated to the claims of other creditors.\(^{16}\)

Other claimants may be involved. These include, for example, buyers or other transferees of the collateral,\(^{17}\) the seller's right of reclamation under article 2 of the Uniform Commercial Code and the Bankruptcy Code,\(^{18}\) or an agent's right to a brokerage commission — the Utica problem.\(^{19}\) Oil and gas transactions pose special problems.\(^{20}\) Summarizing the rights and relative priorities of these and other claimants,

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\(^{10}\) Mid-Continental Casualty Co. v. First Nat'l Bank & Trust Co., 531 P.2d 1370 (Okla. 1975).
\(^{12}\) Id. at § 548.
\(^{13}\) Id. at § 545.
\(^{14}\) Id. at § 547.
\(^{15}\) Id. at § 724.
\(^{16}\) Id. at § 510(c).
\(^{20}\) See Section III, infra.
in and out of bankruptcy, is the purpose of this article.

II. The Rights of the Consensual Secured Creditor

A. Priority in Purchase Money Transactions

Initially, at least, priority disputes between consensual secured creditors are the simplest cases to deal with, because they involve the traditional first-in-time, first-in-right priority rule. In effect the first creditor to properly record a mortgage, file a UCC-1 financing statement, or otherwise perfect his or her security interest has first priority. There are, however, numerous exceptions to the first-in-time rule, for example purchase money transactions. A creditor with "purchase money priority" will prevail over certain other secured creditors, including some prior in time. The Oklahoma statutes also provide a vendor's lien to secure payment of the purchase price of real estate, and a seller's right to reclaim personal property upon default by the buyer.

First, consider purchase money priority under the Uniform Commercial Code. Purchase money status, defined by section 9-107 of the Code, essentially means that the security interest is taken to secure a debt for the purchase price of the collateral. Refinancing the purchase money debt or combining it with other debts may result in loss of purchase money status and priority. There are some subtle distinctions in the scheme of purchase money priority. For example, in order to achieve purchase money priority against another Uniform Commercial Code security interest, the inventory security interest must meet the requirements of section 9-312(3) of the Code. The security interest must be perfected at or before the time the debtor receives possession of the collateral and the secured party must give certain notification to other secured

parties. However, under Oklahoma law for the same purchase money inventory security interest to have priority over a conflicting lien creditor, the security interest need only be filed within twenty days after the debtor receives possession of the collateral and there is no notification requirement. 25 For purposes of this priority provision the term "lien creditor" includes a trustee in bankruptcy, receiver, or assignee for the benefit of creditors. 26 For purchase money priority in Code collateral other than inventory and non-vehicle consumer goods, the twenty day grace period applies in all cases. 27

In a real estate sale the seller can claim a vendor's lien. 28 This gives the seller of real estate a statutory non-possessory lien on the realty to secure payment of the unpaid purchase price. Interestingly, the Uniform Commercial Code does not contain a direct equivalent of the real estate vendor's lien. This lien is specifically made subject to the rights of good faith purchasers and encumbrancers without notice. In Oklahoma, a judgment creditor does not qualify as a bona fide purchaser and hence should be subordinate to a vendor's lien. 29 A vendor's lien, however, should be subordinate to an unrecorded mortgage executed in good faith and without notice of the vendor's lien. This results not only from the language of the vendor's lien statute, 30 but also from a reading of title 16, section 15 of the Oklahoma Statutes, which renders unrecorded instruments invalid against third parties. A lien creditor does not qualify as a protected "third party" within

25. Okla. Stat. tit. 12A § 9-301(2) (1981), amended by Act of May 23, 1985, ch. 88, 1985 Okla. Sess. Law Serv. 272 (West) (effective Nov. 1, 1985) (emphasis added). The Bankruptcy Code provision allowing an exception to the automatic stay and the preference rules for the purpose of perfecting a security interest continues to be effective for only ten days after the transfer takes effect between the parties. 11 U.S.C.A. §§ 362(b)(3); 547(e)(2)(A) (West Supp. 1985). Creditors should, therefore, perfect their purchase money security interest within ten days of transfer so that they will protect their interests in the event the debtor files a bankruptcy petition.


the meaning of this statute.\textsuperscript{31}

Prior to 1978, a trustee in bankruptcy would occupy the status of a judgment lien creditor and therefore would be subordinate to a vendor’s lien.\textsuperscript{32} The revisions to the Bankruptcy Code as a part of the Bankruptcy Reform Act of 1978, however, additionally give the trustee or debtor-in-possession the rights of a bona fide purchaser of the real property of the debtor.\textsuperscript{33} Presumably, this qualifies the trustee for priority over an unrecorded vendor’s lien or unrecorded mortgage.

In the absence of a direct Uniform Commercial Code equivalent to the real estate vendor’s lien, the Code provides the seller of personal property a statutory right to reclaim goods sold to an insolvent buyer. Section 2-702(2) of the Uniform Commercial Code permits the seller to reclaim goods sold on credit if the buyer receives those goods while insolvent and if the seller makes demand for reclamation within ten days after delivery to the buyer. The ten day limitation does not apply if the buyer made a written misrepresentation of solvency, such as a fraudulent loan application or financial statement, within three months prior to delivery.\textsuperscript{34} The seller’s right to reclaim under section 2-702(2) is subordinate to the rights of a buyer in the ordinary course of business or other good faith purchaser of the goods.\textsuperscript{35} “Buyer in the ordinary course of business” and “good faith purchaser” are terms of art that are carefully defined in the Uniform Commercial Code. For example, “buyer in the ordinary course of business” as defined in section 1-201(9) of the Code cannot include a secured creditor; but “purchaser” as defined by sections 1-201 (32) and (33) may include a creditor. Therefore, a good faith purchaser as described and protected in the reclamation provision\textsuperscript{36} may include a secured creditor who extended credit to

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  \item[31.] See Oklahoma State Bank of Wapanucka v. Burnett, 65 Okla. 74, 162 P. 1124 (1917); Green, Unrecorded Mortgage Vis-a-Vis a Judgment Lien, 47 Okla. B.J. Q 121 (1976). See also Buell Cabinet Co. v. Sudduth, 608 F.2d 431 (10th Cir. 1979).
  \item[35.] Id. at § 2-702(3).
  \item[36.] Id.
the insolvent buyer in good faith. Such a creditor may then be entitled to priority over the seller's right to reclaim.37

The Bankruptcy Code also provides for a seller's right to reclaim, but restricts this right to cases when the seller makes a written demand within ten days after the debtor has received the goods.38 The Bankruptcy Code establishes the right of a grain producer to reclaim grain from a bankrupt grain elevator if written demand is made within ten days of delivery to the elevator.39 The seller's right of reclamation under section 2-702(2) of the Uniform Commercial Code is not a statutory lien and thus is not subject to avoidance under section 545 of the Bankruptcy Code.40

To protect the financer of a real estate purchase, the Oklahoma statutes provide purchase money priority for certain mortgage liens:

A mortgage given for the price of real property, at the time of its conveyance, has priority over all other liens created against the purchaser, subject to the operation of the recording laws.41

Although there is a paucity of authority dealing with this section, it seems clear that a recorded purchase money mortgage prevails over a statutory vendor's lien.42 Beyond this, however, the language of the statute makes clear that the effect of the statute is limited to priority over liens against the purchaser. It would not give a mortgagee priority over other liens against the seller's title. Therefore, it is incumbent upon purchase money mortgagees to clear all liens against the seller's interest in the property.

B. Fixture Security Interests

Another exception to the first-in-time rule may arise in the context of a fixture security interest. If personal property subject to a Uniform Commercial Code security interest is af-

39. See id. at § 546(d).
40. See id. at §§ 545, 101 (39); In re Federal's Inc., 533 F.2d 509 (6th Cir. 1977).
fixed to realty, a conflict may arise between the Code security interest and the owner or mortgagee or lienor of the real property. The problem typically arises when a secured party sells or makes a loan for fixture home improvements. Generally, a "fixture" is any item of personal property that is permanently affixed to real estate but which can be removed without structural injury to the realty. Examples might include awnings, patio covers, light fixtures, air conditioners, carpets, storm doors and windows, or security and fire alarms. The term does not include anything incorporated into the structure, such as bricks, lumber, tile, glass or shingles. These are no longer personal property and are not subject to a Code security interest. The 1972 Uniform Revision to the Uniform Commercial Code states that a good becomes a "fixture" whenever it becomes "so related" to real estate that an interest in it arises under local real estate law.

Generally, a perfected security interest in a fixture will have priority over a competing realty interest where: (1) the security interest is a purchase money security interest perfected by a fixture filing before the good became a fixture, or within ten days thereafter, and the realty interest also arose before the good became a fixture; or (2) the security interest was perfected by a fixture filing before the realty interest was of record, the debtor has a recorded or possessory interest in the realty, and there is no predecessor of the realty interest entitled to priority; or (3) the fixtures are "readily removable factory or office machines" or consumer appliances, and a security interest was perfected by an allowable means before the goods became fixtures; or (4) the realty interest is a judicial or equitable lien obtained after the security interest was per-

44. Id. at § 9-313(1)(a). The 1972 uniform act revisions were adopted in modified form in Oklahoma in 1981.
45. Id. at § 9-313(4)(a). It is interesting to note that while the filing period for purchase money priority at sections 9-301(2) and 9-312(4) was recently extended to twenty days after the debtor receives possession of the collateral, the Oklahoma legislature chose not to amend the filing period for purchase money priority in fixtures provided at section 9-313(4)(a).
46. Id. at § 9-313(4)(b).
47. Id. at § 9-313(4)(c).
fected. This preserves the basic first-in-time rule ((2) and (4) above), recognizes purchase money priority ((1) above), and allows recovery of "readily removable" goods in any case ((3) above).

In order to prevail over a realty owner or mortgagee under (1) or (2) above, the security interest must be perfected by a "fixture filing." A recent amendment to the Oklahoma statutes makes clear that a "fixture filing" may be recorded without the acknowledgment required for a real estate mortgage. In addition, unperfected secured creditors are allowed priority whenever the holder of the realty interest has consented in writing or has disclaimed an interest in the fixtures, or where the debtor has the right of removal. Other than in the circumstances described above, the security interest is subordinate to the competing realty interest.

Notwithstanding any of the above rules, a security interest is subordinate to a construction mortgage recorded before the goods became fixtures if the fixtures were added during construction. The holder of a refinanced, construction mortgage is entitled to the same priority as the construction mortgage. A mortgage is sufficient as a financing statement for fixtures, and does not require a continuation statement. A construction mortgage, however, qualifies for the special protection described above only if it is labeled as such or otherwise indicates that it is a construction mortgage.

The fixture provisions were completely changed by the

48. Id. at § 9-313(4)(d).

49. A fixture filing is a filing where a real estate mortgage would be recorded.


52. Id. at § 9-313(7).

53. Id. at § 9-313(6).

54. Id.


1972 Uniform Revisions, which were enacted in 1981 in Oklahoma. It should be noted that a possible priority trap lurks in the purchase money provision described above.\(^57\) If the goods become fixtures on Monday, a real estate mortgage is recorded on Wednesday, and the fixture security interest is perfected on Friday, the fixture secured creditor will be within the ten day grace period allowed by the purchase money provision.\(^58\) Yet the fixture secured creditor will lose to the real estate mortgagee because section 9-313(4)(a) of the Uniform Commercial Code gives priority only if the realty interest arose before the goods became fixtures. Because section 9-313(4)(b) only gives priority over real estate interests recorded after the fixture filing, use of the ten day grace period creates a “gap” between affixation of the good to the realty and perfection by fixture filing. There is no protection for fixture security interests against a real estate interest recorded during this gap. In other words, if a purchase money secured creditor makes a fixture filing after the goods are affixed to the realty, as permitted by the ten day grace period in section 9-313(4)(a) of the Uniform Commercial Code, the fixture security interest will be subordinate to any realty interest that arises during the period between the affixation and filing.

It should also be noted that an ordinary mortgage recorded as such may qualify as a fixture filing if the collateral description in the mortgage sufficiently describes the fixtures.\(^59\) A fixture filing may in turn entitle the creditor to priority outside the usual first-in-time scheme.\(^60\) For example, a creditor who takes a second mortgage on real estate to finance home improvements may, without realizing it, be entitled to first priority as to fixtures installed as part of the project.\(^61\) The fixture priority rules, however, apply only to a conflict between a Uniform Commercial Code fixture security interest and a realty interest. A priority dispute between two Code se-

\(^{57}\) Id. at § 9-313(4)(a).

\(^{58}\) Id.

\(^{59}\) Id. at § 9-313(1)(b).

\(^{60}\) See id. at § 9-313(4)(a) & (c).

security interests or between two real estate liens or mortgages will be resolved by other provisions of the Uniform Commercial Code or by real property law. 62

C. Proceeds of the Collateral, Future Advances, and After-Acquired Property

The issue of proceeds becomes relevant upon sale of the collateral. Generally, if the debtor wrongfully sells the collateral the secured party is entitled to follow that collateral into the hands of the purchaser, 63 unless it is personal property purchased in the ordinary course of business. 64 In any case, the secured party also has recourse against the proceeds of the sale of the personal property collateral. In the event of sale, article 9 of the Uniform Commercial Code provides for continuation of the security interest in both the original collateral and the proceeds until the debt is satisfied. 65 The secured party may pursue either or both until the debt is satisfied. As long as each item of proceeds can be identified as having been received from the sale, for example by means of equitable tracing, it remains “identifiable proceeds” and is subject to the security interest. 66 “Proceeds” is defined as “whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds,” including insurance proceeds. 67

For example, suppose that a consumer owns an automobile subject to a perfected security interest. Without paying off the loan, the consumer sells the car to her neighbor, taking in return another car, a promissory note, some cash, and a check. As long as these items remain identifiable as proceeds of the sale, the secured party may be able to choose between repossessing the original collateral and pursuing any of the proceeds. In this example, the neighbor does not take free of the security interest created by the seller under section 9-307 of the Code because this was not a sale by a dealer “in the

64 See id. at § 9-307; see also §§ 9-308, 9-309.
65 Id. at § 9-306(2). Again, this is subject to § 9-307.
66 Id. at § 9-306(1) & (2).
67 Id. at § 9-306(1).
ordinary course of business."

Recognizing a security interest in proceeds is one thing; establishing the priority of that security interest in proceeds is something else. The general rule is that a perfected security interest automatically continues to be perfected in proceeds of the collateral for ten days after the sale. After that ten days, it becomes unperfected unless: (1) the "filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the [same county] and, if the proceeds are acquired with cash proceeds, the description . . . in the financing statement indicates the types of property constituting the proceeds;" or (2) the "filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds;" or (3) "the security interest in the proceeds is perfected [by the appropriate filing or possession] before the expiration of the ten-day period." If these steps are not taken within ten days of the sale, the secured party has an unperfected security interest in the proceeds. If perfection is accomplished within the ten days, the security interest continues to have priority based on the original perfection date. As previously noted, there is a special provision for purchase money priority. The 1972 amendments to the model Uniform Commercial Code permit continuation of purchase money priority in the proceeds of collateral, other than inventory; for inventory collateral the purchase money priority is limited to "identifiable cash proceeds," defined as including identifiable money, checks, and deposit accounts.

Much of the foregoing is inapplicable in the event of debtor insolvency. Special rules provide for enforcing the security interest against cash proceeds in the event of insolvency proceedings, such as receivership or bankruptcy. In such cases the security interest in the proceeds is limited to: (1) "identifiable non-cash proceeds," including "separate de-

68. Id. at § 1-201(9).
70. Id. at § 9-306(3)(b).
71. Id. at § 9-306(3)(c).
posit accounts containing only proceeds;"73 (2) identifiable cash proceeds not commingled, such as money or checks;74 and (3) commingled cash proceeds received by the debtor during the ten days before the insolvency proceeding was commenced, subject to set off.75 A primary effect of the insolvency provisions is to limit the secured party's ability to trace funds in or through an unsegregated bank account. Such tracing is limited to the ten day period before insolvency. The creditor, however, may be able to recover funds from the bank account equal to the creditor's entire proceeds for that period, regardless of the source of the funds in the account.76 The secured party's right to identifiable proceeds not commingled is unimpaired. This preserves secured party priority as to segregated bank accounts containing solely proceeds of the creditor's security interest.

Future advances and after-acquired property pose different problems. The future advances problem is illustrated by the following hypothetical. First, suppose that creditor number one makes a loan to the debtor, obtains a security interest and files a financing statement (creditor number one is the first to file and perfect). Creditor number two then makes a loan and perfects a security interest in the same collateral. Creditor number one later makes an additional advance ("future advance"), on the same collateral. Is this additional advance by creditor number one entitled to the same priority as the original loan? Does this future advance relate back to the original perfection for the purpose of priority, or is it subordinate to the claim of the intervening creditor?

There are several potential solutions to this problem. If the original security agreement contained a future advances clause — a provision specifically covering future advances —

74. Id. at § 9-306(4)(b) & (c).
75. Id. at § 9-306(4)(d).
creditor number one will have first priority as to all advances, unless creditor number two was a purchase money secured party who perfected before the debtor obtained possession of inventory collateral and met certain notice requirements, or perfected within twenty days of delivery to the debtor as to other collateral. 77 Alternatively, if creditor number one terminated his perfection, for example, by terminating the original financing statement, otherwise released the collateral, or signed a subordination agreement, his claim will be subordinate. But if creditor number one did not include a future advances clause in the original security agreement and there has been no termination statement or subordination agreement, the problem is more difficult.

In a landmark case, Coin-O-Matic Service Co. v. Rhode Island Hospital Trust Co., 78 the court said that creditor number one would not have priority as to the future advance because the future advance was a separate transaction and there was no evidence that the original security agreement and financing statement were intended to cover that advance. This view has been criticized, and an equally famous decision in a nearly identical case is to the contrary, holding that future advances are perfected by the original financing statement, with or without a future advances clause, as long as the advances are covered by either a new security agreement or a future advances clause in the original security agreement. 79 This view has found the widest acceptance and has been approved by the Uniform Commercial Code Editorial Board and incorporated into the 1972 amendments to the model Uniform Commercial Code. 80 Under this view, an initial filing of a financing statement, with or without a future advances clause, will perfect all future advances against that collateral and will provide priority based on the original filing date, so long as the advances are covered under a security agreement and are made while the original security interest is perfected.

There was some authority in Oklahoma for the latter view. In *First National Bank v. Atlas Credit Corp.*,\(^{81}\) the bank made a loan to a rancher in 1963 and filed a financing statement but did not execute a security agreement. Atlas subsequently perfected a security interest in the same collateral. The bank later advanced additional funds to the rancher and finally had the rancher execute a security agreement. The court held that the bank's original and future advances related back to the original financing statement for purposes of perfection, and the bank was given priority as to all its advances.

*Texas Kenworth Co. v. First National Bank of Bethany*,\(^{82}\) however, changed all of that and established Oklahoma as a state openly hostile to future advances. The facts in *Texas Kenworth* developed in three stages. In 1967, Texas Kenworth sold four trucks to the debtor. Security agreements were executed and financing statements were filed, but there were no future advances clauses. In 1971, the bank perfected a security interest in all of the debtor's equipment, including these trucks. In 1972, Texas Kenworth cancelled the original security agreements and then advanced funds to the debtor under a "lease-back" arrangement. The original financing statement was left on file and the transaction was treated as a future advance. The Oklahoma Supreme Court concluded that Texas Kenworth lost its priority when the original security agreements were cancelled. The future advance did not relate back to the original financing statement because there was no future advances clause in the original security agreement. A provision that the security interest would not be considered released until "all other indebtedness from Buyer to Secured Party are fully paid" was not considered a future advances clause, and the intervening creditor bank was given priority.\(^{83}\)

A subsequent case, *Security National Bank v. Dentsply Professional Plan*, indicated that to be protected by an earlier filing, the advance also must be the same "class of obligation" as the initial advance, and must be made pursuant to a future

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81. 417 F.2d 1081 (10th Cir. 1969).
82. 564 P.2d 222 (Okla. 1977).
83. Id. at 225-27.
advances clause.\textsuperscript{84} \textit{Texas Kenworth} and \textit{Dentsply} seem to have established Oklahoma as one of the strictest jurisdictions regarding future advances.\textsuperscript{85} The "same class" doctrine, however, has been called into question by a recent bankruptcy court decision.\textsuperscript{86} Moreover, the 1972 Uniform Amendments, adopted in Oklahoma in 1981, seem to reject the \textit{Texas Kenworth} position in favor of a straight first-to-file or first-to-perfect priority system. Nonetheless, the strength of the case law in Oklahoma state courts suggests some possibility that these courts will continue to follow a hard line on future advance priorities.

In summary, it should be noted that this future advances problem is a security agreement problem rather than a financing statement problem. It seems settled that a financing statement can cover future advances on the collateral without a future advances clause. The question is whether future advances can be covered without specific language in the original security agreement that the parties intended to cover future transactions. Although the cases can be reconciled on factual distinctions, there seem to be two opposing views. One view is that future advances are not covered by the original financing statement for priority purposes unless the original transaction clearly contemplated the future advances, for example, where the original security agreement contains a future advances clause. This is the Oklahoma view. The other view is thought to be the prevailing rule in most other jurisdictions: once a security interest is filed or perfected, all advances made on the collateral by the secured party pursuant to a security agreement relate back to that original filing or perfection for purposes of priority.

Future advances by a perfected secured creditor have priority over a lien only to the extent the advances were made before the lien attached or within forty-five days thereafter, or


\textsuperscript{85} \textit{Id.}

to the extent the advances were made or committed to without knowledge of the lien.\textsuperscript{87} Future advances have priority over a buyer not in the ordinary course of business only if made before or within forty-five days after the purchase, or if made or committed to without knowledge of the purchase.\textsuperscript{88} Future advances secured by a real estate mortgage are not entitled to priority unless obligatory upon the mortgagee.\textsuperscript{89}

The after-acquired property problem, also described as the “floating lien,” involves new collateral rather than new advances. For example, if a secured party takes a security interest in dealer’s present inventory or accounts, the collateral will gradually be diminished as the inventory is sold or the accounts paid. Ultimately all of the old collateral will have been sold and replaced with new inventory or accounts. Since section 9-307 of the Uniform Commercial Code allows sale free of the security interest, the inventory secured creditor will lose its claim to the original collateral. The original accounts collateral will simply dissipate. Therefore, article 9 permits a secured party to take a security interest in “after-acquired” property as well. One filing is sufficient to perfect as to both present and after-acquired collateral. The security interest “floats over” whatever collateral of that type the debtor owns and acquires.

It is unnecessary that the financing statement have a specific after-acquired property clause; however, a description in the financing statement that is too narrow or is specifically limited may exclude coverage of after-acquired property.\textsuperscript{90} For example, “all equipment and cash registers, including cash register [number] 21366” is sufficient as a description to cover after-acquired cash registers and adding machines. A financing statement covering only “cash register [number] 21366” would not, however, cover any after-acquired property. In contrast, it is necessary that the security agreement specifically evidence an intent to cover after-acquired property.

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\textsuperscript{88} Id. at § 9-307(3) (1981 & Supp. 1984).
\textsuperscript{90} U.C.C. § 9-204, comment 5 (1977).
\end{flushright}
provision in the security agreement covering "all equipment and replacements" would be sufficient; it is unnecessary that any special language be used.\textsuperscript{91}

There are some exceptions to these rules. An after-acquired property clause is generally valid as to all types of collateral and all parties, except that an after-acquired property clause is invalid as to consumer goods other than accessions, unless the consumer acquires them within ten days of the loan.\textsuperscript{92} The latter qualification is intended to cover purchase money transactions.\textsuperscript{93} In addition, an after-acquired property security interest may be subordinate to the rights of a purchase money secured party.\textsuperscript{94}

III. Creation and Priority of Judicial Liens in Oklahoma

A. Creation of Judicial Liens

By statute, a judgment creates a lien on property of the judgment debtor.\textsuperscript{95} A judicial proceeding results in a judgment lien when a court of record issues a final money judgment, and a certified copy of this judgment is filed in the office of the county clerk of that county.\textsuperscript{96} This creates a judgment lien on all real property of the judgment debtor situated in that county.\textsuperscript{97} If the debtor owns land in other counties, additional certified copies must be filed in those counties.\textsuperscript{98}

In general, a district court where the land is located cannot interfere with the execution and collection of a judgment rendered by a district court in another district.\textsuperscript{99} When a judgment is filed in a county other than the one in which the judgment was issued, the court in the county in which the filing occurs does not acquire the power to inquire as to the

\textsuperscript{91} Id. at § 9-204, comment 2.
\textsuperscript{92} Id. at § 9-204(2).
\textsuperscript{94} See U.C.C. § 9-312(3) or (4) (1977).
\textsuperscript{96} Id.
\textsuperscript{97} Id.
\textsuperscript{98} Id.
\textsuperscript{99} Chandler v. Cummins, 183 Okla. 5, 81 P.2d 651 (1938); Reynolds v. District Court of Wash. County, 198 Okla. 326, 177 P.2d 830 (1947).
judgment's validity.\textsuperscript{100}

A judgment lien attaches only to the actual interest held by a judgment debtor in the real estate.\textsuperscript{101} For example, where a judgment debtor is involved in a real estate partnership, and a judgment creditor attempts to attach a lien to the debtor's partnership interest, the Oklahoma courts have indicated that the partners may not have an individual interest in property of the partnership.\textsuperscript{102} If the judgment debtor does not have an individual interest in the property, a judicial lien may not attach under the statute.

Once a judgment lien attaches to the land, the general rule is that it remains with the land and cannot be destroyed by the debtor's subsequent alienation of the property.\textsuperscript{103} If the debtor sells the property to a third party, then the purchaser would take the land subject to the judgment lien unless the judgment creditor waives or releases the lien.\textsuperscript{104}

Equitable interests in real property are recognized under Oklahoma law, and in certain instances the courts have allowed judgment liens against these equitable interests.\textsuperscript{105} In a case where a party had a ten percent interest in a real estate joint venture, the court, applying Oklahoma law, recognized the equitable interest in the real estate and allowed a judicial lien to attach to this interest.\textsuperscript{106} A judgment creditor cannot rely on record title to determine if a party has an interest in real property or the extent of his interest because the recording statutes were enacted to protect bona fide purchasers and third party creditors rather than judgment creditors.\textsuperscript{107} When the actual interest of the judgment debtor is less than one hundred percent or where equitable title is in another person, the lien will not attach to the full legal title of record.\textsuperscript{108} Con-

\textsuperscript{100} McAusland v. Williams, 177 Okla. 25, 54 P.2d 622 (1935).
\textsuperscript{101} White House Lumber Co. v. Howard, 142 Okla. 163, 286 P. 327 (1930).
\textsuperscript{102} Buell Cabinet Co. v. Sudduth, 608 F.2d 431 (10th Cir. 1979).
\textsuperscript{103} Harbin v. Brooks, 25 Bankr. 703 (Bankr. W.D. Tenn. 1982).
\textsuperscript{104} Id.
\textsuperscript{106} 461 F.2d at 1036.
\textsuperscript{107} Buell Cabinet Co., 608 F.2d at 435.
\textsuperscript{108} Harry v. Hertzler, 185 Okla. 151, 90 P.2d 656 (1939); City Guaranty Bank v. Boxley, 132 Okla. 183, 270 P. 69 (1928); J.I. Case Threshing Mach. Co. v. Walton
versely, the lien should attach to a judgment debtor’s equitable interest notwithstanding that legal title is in another.

Judgments issued by federal district courts in Oklahoma become liens on real property in the same manner and to the same extent as judgments rendered by state courts.\textsuperscript{109} A judgment from a federal district court in another state would have to be registered in an Oklahoma federal district court, and a judgment so rendered should have the same effect as a judgment of the district court where it was registered.\textsuperscript{110} A certified copy must then be filed with the appropriate county clerk and the judgment lien would be effective against the real estate in that county as of the date of the filing.\textsuperscript{111}

A judgment lien remains valid for a period of five years from the date the judgment is rendered.\textsuperscript{112} This period may be extended by issuance of execution before the end of the five year period.\textsuperscript{113} A certified copy of the execution must be filed in the county where the judgment was rendered and in each county where the lien is to be retained.\textsuperscript{114} This filing of the execution in the office of the county clerk will effectively extend the life of the judgment lien for five years from the date of filing.\textsuperscript{115} If the execution does not occur within the five year period provided by statute, the judgment lien will become

\begin{itemize}
\item Trust Co., 39 Okla. 748, 136 P. 769 (1913).
\begin{quote}
Every judgment rendered by a district court within a State shall be a lien on the property located in such State in the same manner, to the same extent and under the same conditions as a judgment of a court of general jurisdiction in such State, and shall cease to be a lien in the same manner and time. Whenever the law of any State requires a judgment of a State court to be registered, recorded, docketed or indexed, or any other act to be done, in a particular manner, or in a certain office or county or parish before such lien attaches, such requirements shall apply only if the law of such State authorizes the judgment of a court of the United States to be registered, recorded, docketed, indexed or otherwise conformed to rules and requirements relating to judgments of the courts of the State.
\end{quote}
\item 113. Id.
\item 114. See id. at § 759; First of Denver Mortgage Investors v. Riggs, 692 P.2d 1358 (Okla. 1984); Ashur v. McCreey, 150 Okla. 111, 300 P. 767 (1931).
\end{itemize}
dormant. The statutory requirement that an execution occur within five years of judgment is strictly construed by the courts, and hearings on assets or garnishment proceedings do not constitute "executions" which would prolong the life of the judgment. Partial payment of the judgment will also not prevent the running of the statute.

The courts have acknowledged a clear and distinct difference between the general statutes of limitation and the statute requiring execution within a five year period, referred to as the "dormancy" statute. Because the judicial lien is unknown in common law, the courts have held that the legislature can fix conditions and requirements relating to the enforcement of a judgment, and that general statutes of limitation are inapplicable. A certified copy of the execution must be filed in the county where the judgment was rendered, and in each county where the lien is to be retained, to extend the lien.

The lien will retain its priority as against other judgment liens only by issuance of execution and levy within one year of rendition. Priority against other claimants, however, including mortgagees and secured parties under the Uniform Commercial Code, will be unaffected by failure to issue execution within one year. When a year has expired from the rendition of any judgment, the first judgment creditor to obtain execution and levy on a judgment debtor's land has priority over other judgment creditors. A judgment lien does not attach

116. Id.
118. Chandler-Frates & Reitz, 630 P.2d at 1287.
120. Chandler-Frates & Reitz, 630 P.2d at 1287; Sebring, 179 P.2d at 125. Such dormancy statutes also run against the state. Charles Banfield Co., 525 P.2d at 638.
121. See Okla. Stat. tit. 12, § 759 (1981); First of Denver 692 P.2d at 1358; Ashur 150 Okla. at 111, 300 P. at 767.
123. Id.
124. Harris v. Southwest Nat'l Bank, 133 Okla. 152, 271 P. 683 (1928). The Harris court stated:
A judgment lien created and limited by a statute cannot be prolonged beyond the period fixed. Nor have the courts any power to extend or give
to the homestead of the debtor. This includes proceeds of
the homestead property.

A judgment lien, when satisfied by payment or otherwise
discharged, shall be released by the court upon written motion
by the judgment debtor. Notice of the motion shall be
mailed to the judgment creditor, and if the judgment creditor
does not object within twenty days, the court shall order the
judgment released.

B. Extent of Judicial Lien

In Oklahoma, personal property is unaffected by a judg-
ment lien. By statute, a docketed and filed judgment atta-
ches as a lien only to the real estate of the judgment
debtor. Most states provide by statute that a judgment lien
is limited to real property. In Alabama, Georgia and Missis-
issippi, however, the judgment lien applies to both real and
personal property.

A judgment lien operates as a general lien in Oklahoma
on all of the judgment debtor’s real property in that county,
and is not a specific lien upon any particular portion of the
judgment debtor’s property. Because the judgment lien did
not exist at common law, the statute creating the judgment
lien establishes the limits beyond which the lien cannot be ex-
tended, and in Oklahoma expressly limits the judgment lien
to real property.

priority of judgments by construction, so as to make exceptions of qualifica-
tions to meet the hardships of particular cases.
271 P. at 686.
125. OKLA. CONST. art. 12, § 2 (1979). See also OKLA. STAT. tit. 31, § 1 et seq.
127. OKLA. STAT. tit. 12, § 706(B) (1981).
128. Id.
129. Id. at § 706.
130. Id.; Burchfield v. Bevans, 242 F.2d 239 (10th Cir. 1957).
132. In re Paolino, 11 Bankr. 317 (Bankr. W.D.N.Y. 1981); In re Lattimore, 12
133. Id.; Astle, An Analysis of the Evolution of Oklahoma Real Property Law
Relating to Lis Pendens and Judgment Liens, 32 OKLA. L. REV. 812 (1979); In re
Staples, 1 F. Supp. 620 (N.D. Okla. 1932); San Juan Constr. Co. v. DeArellano (In re
To extend a judicial lien to personal property it is necessary that the creditor obtain an execution and levy, thereby creating an "execution lien" to enforce the judgment. The filing of the judgment does not create a lien against personal property, and a lien against personal property is created only on levy and execution. Until such time as the judgment creditor succeeds in levying execution on specific property, there is no judicial lien on personal property under Oklahoma law.

C. Foreign Judgments

A foreign judgment from another state can be enforced under the Uniform Enforcement of Foreign Judgments Act. Prior to the Uniform Act the only method of enforcing a valid judgment of a sister state was to prosecute a new law suit. Today a foreign judgment may be filed in the office of the court clerk in any county in the state. A foreign judgment does not, however, become a lien on the real estate of the judgment debtor until a certified copy of the judgment is filed in the office of the county clerk where the real estate is located. Once a foreign judgment is filed with the court clerk, it is subject to the same rights, procedures, and defenses as a judgment of a district court of that state. An affidavit setting forth the name and last known address of the judgment debtor and creditor must be filed with the court clerk along with the judgment, and notice of the filing must be promptly given to the judgment debtor. Execution or enforcement of a foreign judgment shall not issue until twenty days after the

(In re Flege), 17 Bankr. 690 (Bankr. N.D. Ohio 1982).
138. Id. at § 721.
139. Id.
date the judgment is filed.\textsuperscript{142}

\textbf{D. Execution and Levy}

To protect his judgment lien the judgment creditor may need to obtain an execution and levy. The Oklahoma statutes provide that "lands, tenements, goods and chattels, not exempt by law, shall be subject to the payment of debts, and shall be liable to be taken on execution and sold, as hereinafter provided."\textsuperscript{143} Execution may be issued only from the court rendering the judgment, and execution by any other court would be void.\textsuperscript{144} The execution is actually issued by the court clerk, and is directed to the county sheriff.\textsuperscript{145} The sheriff is required to satisfy executions in the order they are delivered to him, except that executions delivered on the same day share pro rata.\textsuperscript{146} The writ of execution orders the sheriff to seize property of the debtor. The seizure is called "levy" and results in an "execution lien."\textsuperscript{147} The property can then be sold by the sheriff and the sale proceeds applied to the debt.\textsuperscript{148}

The Oklahoma statutes require that the officer to whom the writ of execution is delivered shall proceed immediately to levy upon the goods and chattels of the debtor, and require that he appraise any lands and tenements of the debtor.\textsuperscript{149} For sale of personal property, notice must be given ten days prior to the sale by publication notice in the county where the sale is to be held.\textsuperscript{150} Where personalty exists, but the sheriff is unaware of its existence, the right to levy and sell the realty is contingent on failure to find personalty, rather than on the nonexistence of personal property.\textsuperscript{151}

\begin{footnotes}
142. \textit{Id.} \\
143. \textit{Id.} at § 733. \\
144. \textit{Id.} at § 706; Garnett v. Goldman, 39 Okla. 516, 135 P. 410 (1913). \\
146. \textit{Id.} at § 737. \\
147. In the case of Pracht v. Pister, 30 Kan. 568, 1 P. 638 (1883), the court said "A levy means this, and nothing more, — the taking possession of property by the officer. When there is possession, absolute or constructive, there is a levy." \textit{Id.} at 639. \\
149. \textit{Id.} at § 802. \\
150. \textit{Id.} at § 757. \\
\end{footnotes}
If the sale of personal property will not satisfy the judgment, the officer is next required to levy upon and appraise any lands and tenements of the debtor.\textsuperscript{152} Notice of the sale of realty must be given by publication for two successive weeks in the county where the land is located.\textsuperscript{153} If the property is real estate, the lands and tenements cannot be sold for less than two-thirds of the appraised value.\textsuperscript{154} The judgment debtor may waive the appraisement requirement, and the sale of the realty will be upheld if the sale price is not so low as to shock the conscience of the court.\textsuperscript{155} If appraisement is waived, no sale or execution can be made on such judgment until six months after said judgment has been entered.\textsuperscript{156}

The trial court, after examining the levy and execution, has a duty to confirm the sale if the proceedings complied with the statutory provisions.\textsuperscript{157} Mere inadequacy of price will usually not be grounds to set aside or disaffirm a sale, unless fraud, duress, or other procedural defects are present.\textsuperscript{158} The sheriff or officer who sells the land on execution and levy shall prepare a deed to convey title to the purchaser; the mere sale by itself never vests title.\textsuperscript{159} \textquotedblleft Where the sheriff’s deed recites the return of an execution, and the proceedings and sale thereunder, and that the court... confirmed the sale and ordered a deed made to the purchaser,... in the absence of a contrary showing, the sale will be presumed to have been confirmed as [recited] in the deed.\textsuperscript{160}

\textsuperscript{153} Id. at § 764.
\textsuperscript{154} Id. at § 762.
\textsuperscript{155} Id. at § 760; Myers v. Carr, 173 Okla. 335, 47 P.2d 156 (1935).
\textsuperscript{156} Okla. Stat. tit. 12, § 760 (1981); Cudjo v. Harris, 119 Okla. 69, 248 P. 343 (1926) (sale within six months is void where appraisal waived, Hancock v. Youree, 25 Okla. 460, 106 P. 841 (1910)).
\textsuperscript{158} University of Tulsa v. Moores, 177 Okla. 548, 61 P.2d 25 (1936); State v. Wilson, 124 Okla. 236, 254 P. 968 (1927).
\textsuperscript{159} Okla. Stat. tit. 12, § 766 (1981); Board of Regents v. Linscott, 30 Kan. 240, 1 P. 81 (1883).
\textsuperscript{160} Christy v. Springs, 11 Okla. 710, 69 P. 864 (1902).
E. Judgment Lien and the Oil & Gas Lease

A number of Oklahoma courts have stated that a judgment lien will not apply to an oil and gas lease because the oil and gas lease, while creating an interest or estate in realty, is not deemed real estate per se.\textsuperscript{161} This characterization of an oil and gas lease as an interest in real property, while not being per se real estate, has been affirmed by the Oklahoma Supreme Court in the recent case of Archon Oil Co. v. Cate.\textsuperscript{162} The Archon court noted a previous decision recognized that:

there is a recognizable distinction between real estate and an estate in real property. Not every kind of estate recognized in law as an interest in real property is real estate. Although an oil and gas lease creates an interest or estate in realty, such interest is not per se real estate.\textsuperscript{163}

Specifically with regard to judgment liens, the Archon court noted that a prior Oklahoma case had stated that:

while an oil and gas lease which grants, leases, and lets' [sic] certain land for oil and gas mining purposes, conveys to the lessee an estate in the realty described therein, such interest is not real estate within the meaning of section 690, C.O.S. 1921, 12 Ok. St. Ann. § 706, which gives a judgment creditor a lien upon the 'real estate' belonging to the judgment debtor.\textsuperscript{164}

Because the oil and gas leasehold is a hybrid estate, with both real and personal property attributes, questions arise as to whether the leasehold as personal property must be levied upon and sold prior to lands and tenements, and whether the leasehold can be sold for less than the two-thirds appraised value for lands and tenements as required by statute. A separate but related issue is whether notice should be given to comply with statutory requirements for personal or real property.

The Oklahoma statutes provide for separate notice requirements for the sale of chattels and the sale of real estate,

\textsuperscript{162} 56 Okla. B.J. 453 (Feb. 23, 1985).
\textsuperscript{163} Id. at 455 (quoting Hinds, 591 P.2d at 697-8).
\textsuperscript{164} Id. at 455 n.1 (quoting Fisher, 185 Okla. at 108, 90 P.2d at 411).
and the issue of which notice requirement applies to the leasehold interest was addressed by the Oklahoma Supreme Court in *Archon*. Title 12, section 757 of the Oklahoma Statutes requires that the notice of the time and place of the sale of chattels be given at least ten days before the day of the sale by advertisement in some newspaper printed in the county. Title 12, section 764 of the Oklahoma Statutes requires that lands and tenements taken in execution shall not be sold until public notice is given by publication for two successive weeks in newspapers printed in the county where the land is located.

In *Archon Oil Co.*, the parties gave notice of the sale of the oil and gas leasehold under the statutory provisions providing for the sale of lands and tenements. The court did not decide the precise issue of whether the statutory notice requirements for personal or real property applied, or whether the leasehold was realty or personalty with respect to levy and execution. *Archon* was decided on the issue of due process, the court requiring that proper notice be given, and that a realistic opportunity should be granted for parties to appear at the judicial sale. Although not required by statute, the court decided that notice must be given to the judgment debtor of the time and location of the sale.

In *Cuff v. Koslosky*, an undivided one-half interest in mineral rights and unaccrued royalties were considered “lands and tenements” under the Oklahoma statutes requiring appraisal before sale, and a sale without the appraisal was considered void. Where realty has been sold without appraisal, and appraisement has not been waived, the courts have held such sales void. For appraisal purposes, it appears that these interests were considered real property under the statutes.

Support can be found for the proposition that the two-thirds appraised value requirement for lands and tenements should not apply to the sale of a leasehold, since the Oklahoma court has held that the oil and gas lease is not *per se* real estate for the purpose of the statutes relating to judg-

165. 56 Okla. B.J. at 453.
166. Id.
ment liens.\textsuperscript{169} In \textit{Pauline Oil & Gas Co. v. Fisher},\textsuperscript{170} the court held that no lien attached until execution and levy was issued on the leasehold, similar to the rule that no lien exists against personal property until the execution and levy.

On the other hand, arguments also can be made that because a leasehold is an interest in realty, although not \textit{per se} real estate, the statutory provisions applying to the sale of real estate should apply. Because this issue is undecided, a judgment creditor may in prudence treat the leasehold as realty, and satisfy those notice requirements and the two-thirds appraised value requirement.

Where a judgment lien is filed against real property and the judgment debtor owns an interest in the minerals, the issue of who would receive the royalties from a subsequently issued oil and gas lease presents an unanswered question in Oklahoma. The judgment lien, being filed prior to the lease in time, would attach to the royalty proceeds if the royalty was classified as real property. If the royalty were classified as personal property, then the judgment lien would not attach to the royalty proceeds, and a lien would not be effective against the personal property until execution. In a recent Pennsylvania case, \textit{Wagner v. Glacial Holding, Inc.},\textsuperscript{171} the court, in reviewing a similar situation involving the royalties due and owing under a lease for coal, stated that the realty/personalty distinction of royalties was irrelevant because the judicial lien applied to the coal in place as real estate when it was filed, and therefore any royalties arising from the mining of the coal would be covered by the judgment lien.

Because oil and gas is not owned in place in Oklahoma, but is classified as an incorporeal hereditament or \textit{profit a prendre}, the oil and gas interest is somewhat different than the coal interest.\textsuperscript{172} Unlike coal, oil and gas is fugitive in nature, and ownership of the hydrocarbons depends on reducing the oil and gas to possession, referred to as the "law of capture."\textsuperscript{173} Because the mineral owner does not own the hydro-

\textsuperscript{169} Pauline Oil & Gas Co., 185 Okla. 108, 90 P.2d 411 (1939).
\textsuperscript{170} Id.
\textsuperscript{171} 30 Bankr. 554 (Bankr. W.D. Penn. 1983).
\textsuperscript{172} Meeker v. Ambassador Oil Co., 308 F.2d 875 (10th Cir. 1962).
\textsuperscript{173} Ohio Oil Co. v. Sharp, 35 F.2d 303, 307 (10th Cir. 1943).
carbons in place, a lien on the mineral estate may not be a lien on the oil and gas.\textsuperscript{174}

In analyzing the nature of the royalty interest, courts have held that unaccrued royalty interests are real property as part of the estate remaining in the lessor, and accrued royalties arising under an oil and gas lease have been classified as personal property.\textsuperscript{175} As such, the unaccrued royalty as real property would be subject to the judgment lien when such lien was filed of record in the county where the leasehold was located. Accrued royalties as personal property under a lease would only be subject to a lien upon execution and levy.

\section{F. Priority of the Judgment Lien}

In general, the priority of a judgment lien is governed by the traditional first-in-time, first-in-right principle, whether the competing claim is another judgment lien, a Uniform Commercial Code security interest, or a real estate mortgage.\textsuperscript{176} There are of course special rules for purchase money transactions, fixtures, future advances, proceeds, after-acquired property and other special situations as previously discussed. Today an additional important special situation is bankruptcy.

\section{G. Bankruptcy Considerations}

\subsection{1. Preface}

A bankruptcy discharge voids any judgment in terms of personal liability or legal responsibility, and prohibits further acts in all forms of attempting to collect from the debtor.\textsuperscript{177} Consequently, a judgment based upon a debt that has been discharged cannot become a lien on the real property.\textsuperscript{178}

\begin{itemize}
\item \textsuperscript{174} White v. McVey, 168 Okla. 19, 31 P.2d 850 (1934).
\item \textsuperscript{175} McCully v. McCully, 184 Okla. 264, 86 P.2d 786 (1939); Cuff v. Koslosky, 165 Okla. 135, 25 P.2d 290 (1933); United States v. Noble, 237 U.S. 74 (1915).
\item \textsuperscript{176} See, e.g., OKLA. STAT. tit. 42, § 15 (1981); U.C.C. § 9-301(1)(b) (1977); OKLA. STAT. tit. 46, § 7 (1981). This assumes all competing claims are properly created, perfected or recorded.
\item \textsuperscript{177} 11 U.S.C.A. § 524(a) & (b) (West Supp. 1985).
\item \textsuperscript{178} Middle Georgia Lumber Co. v. Hunt, 53 Ga. 578, 186 S.E. 714 (1936). A pre-bankruptcy judgment lien does remain of record and may technically constitute a cloud on the title, since a bankruptcy discharge voids only the personal liability and
\end{itemize}
The taking and docketing of a judgment against the debtor's real property, or any judicial proceeding that fixes a lien upon the property of the debtor, constitutes a "transfer" within the meaning of section 547 of the Bankruptcy Code. 179 Because of the comprehensive definition of a "transfer" in the Bankruptcy Code, the entry of a judgment and the creation of a lien in pursuance thereof may give rise to a preferential transfer. A transfer is defined as including "every mode direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property." 180

It is clear that not only any form of a judgment, but any other judicial proceeding or contractual arrangement that fixes a lien upon the property of the debtor and that comes within the other requisites of section 547(b) may constitute a preference. 181 A transfer will have been deemed to have been made when the lien attached to the debtor's property, a question which is controlled by state law. 182

In Oklahoma, the judgment becomes a lien against real property when it is recorded in the county where the real property is located. 183 A confession of judgment or a recording of a judicial lien within ninety days of bankruptcy (one year for "insiders") may be a preference if all of the other necessary elements for a preference are present. These elements include: (1) the transfer was "to or for the benefit of a creditor;" (2) the transfer was made for or on account of an "antecedent debt;" (3) the debtor was insolvent at the time of the transfer; (4) the transfer was made within ninety days before the date of the filing of the bankruptcy petition (one year for "insid-

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180. Foluke, 38 Bankr. at 300. See also Glessner v. Massey-Ferguson, Inc., 353 F.2d 986 (9th Cir. 1965).


ers"); and (5) the transfer had the effect of increasing the amount the transferee would receive in a Chapter 7 proceeding.\textsuperscript{184}

The Bankruptcy Code is concerned primarily with judgment liens that are created within the ninety day (or one year) preference period to secure claims that have no previous preferential standing.\textsuperscript{185} The enforcement of a valid and existing lien arising prior to the ninety day (or one year) preference period, which has priority over the claims of general creditors and against which a trustee cannot assert a paramount right, does not constitute a voidable preference.\textsuperscript{186}

In Oklahoma, a judgment lien only arises against real property.\textsuperscript{187} For this reason, a preference could be created with regard to the debtor's personal property if the judgment creditor proceeds to execute and levy on the property within ninety days of the filing of the bankruptcy petition. In Adler v. Greenfield,\textsuperscript{188} the court stated: "[i]t makes no difference that the judgment was obtained more than four months prior to the filing of the petition in bankruptcy. The judgment alone gives no lien against the debtor's personal property until the execution against it is delivered to the proper officer to be executed."\textsuperscript{189} The Adler court held that because the execution created a lien on the debtor's personal property in the preference period, the transfer was voidable by the trustee.

The requirement that execution issue within five years of judgment, or within one year to maintain the judgment creditor's status in relation to other judgment creditors, may be tolled by the filing of bankruptcy by the judgment debtor.\textsuperscript{190}

\begin{flushright}
186. In re LaFortune, 652 F.2d 842 (9th Cir. 1981) (example of a judgment enforcing a valid statutory mechanics' and materialmen's lien entered within the 90 day preference period).
188. 83 F.2d 955 (2d Cir. 1936).
189. Id. at 956. The Adler court was applying New York law, which requires execution before a lien is created against the debtor's personal property, identical to Oklahoma. Also, the preference period under earlier versions of the Bankruptcy Code was 4 months, and has since been reduced to 90 days. See 11 U.S.C.A. § 547(b) (West Supp. 1985).
\end{flushright}
The automatic stay may prevent a creditor from enforcing his lien, unless the stay is lifted by the court.\textsuperscript{191} Therefore, tolling the time period to execute on a judgment lien may be proper.

2. The Hypothetical Lien Creditor

In the oil and gas industry in Oklahoma it is a fairly common practice for certain oil and gas interests or conveyances not to be filed in the real estate records of the county clerk. A "farmout," where a party reserves a non-cost bearing overriding royalty interest in a lease while transferring the cost bearing working interest to another party, is rarely recorded by either party. The parties generally draft a farmout contract detailing their rights and obligations involving the drilling of a well, and providing for the terms and circumstances of an assignment of the leasehold. The intent of the party reserving the overriding royalty interest is to limit its risk or loss in the event of a dry hole by transferring the cost bearing interest, reserving only a non-cost bearing interest. Overriding royalty interests assigned to geologists or landmen as compensation sometimes are not timely recorded or the assignment is made after the well has begun producing.

Under section 544(a) of the Bankruptcy Code the trustee or debtor in possession has, as of the filing of the case, the power to avoid any transfer of property by the debtor and has the powers of: (1) a judicial lien holder; (2) an execution lien holder; or (3) a bona fide purchaser of real property.\textsuperscript{192} The fact that many oil and gas conveyances are unrecorded raises the issue of whether the trustee can avoid the transfer of property by the debtor under the powers of section 544(a).

Under section 544(a)(3) the trustee obtains the right of "a bona fide purchaser of real property" to avoid a transfer of property by the debtor. The trustee's avoidance powers under this section as a bona fide purchaser apply only to real property, not to personal property.\textsuperscript{193} The failure to record a real

property conveyance in Oklahoma would allow a bona fide purchaser to take title to such property, and as such may allow the trustee to avoid any transfer of unrecorded real property to the unrecorded grantee. 194

An example of the trustee’s avoidance power under section 544(a)(3) is illustrated in the case of Washburn & Roberts, Inc. v. Park East, 195 where the debtor gave a warranty deed for real estate to the defendants. The defendants failed to record the deed prior to the time of the bankruptcy filing, and the trustee as a bona fide purchaser under section 544(a)(3) could avoid the unrecorded transfer of property under the applicable state law requiring recording of real estate conveyances. The property was thus part of the bankruptcy estate.

Similarly, in Brent Explorations, Inc. v. Karst Enterprises Inc., 196 a creditor obtained a production payment from certain wells for the payment of debts owed for materials supplied to a well. The creditor’s claim to the production payment was not perfected under the law pertaining to either real or personal property, and the debtor subsequently filed bankruptcy. The Brent court held that the debtor in possession could avoid the production payment because it had not been perfected. Because the debtor in possession is given the status of a party without knowledge of the obligation by the express terms of section 544(a), the fact that the debtor in possession had knowledge of the production payment was irrelevant in determining if the debtor could avoid the transfer under section 544.

Where the trustee acquires the status of a bona fide purchaser of realty under section 544(a)(3), the question becomes whether the trustee can avoid an unrecorded farmout or overriding royalty interest. The farmout and overriding royalty interests both deal with the conveyance of an interest in a leasehold. In Oklahoma the leasehold interest has been classified as an incorporeal hereditament, or profit a prendre, and has been said to be a hybrid estate with both real and personal

property characteristics. While not constituting real estate in the context of being subject to the statutory judgment lien against real property, the oil and gas lease must be recorded as an instrument relating to real estate in order for the lease to be valid against third parties.

An oil and gas lease is construed as real property for recording purposes in Oklahoma, and recording puts third parties on notice of ownership interests. Where an assignment of a leasehold interest is due under a farmout or overriding royalty contract, but is not recorded, the trustee as a hypothetical bona fide purchaser may be able to avoid such an unrecorded interest under section 544(a)(3), but only if the leasehold interest is characterized as real property (an unlikelihood in view of the Oklahoma caselaw previously discussed).

Because the trustee is also given the rights of an ideal creditor without knowledge or notice, the fact that the grantee whose deed is not of record is in open and notorious possession will not put the trustee on notice of competing claims under section 544(a). "One of the purposes for providing the ideal creditor status is to prevent such defenses as estoppel from being raised against the trustee." Therefore, if the trustee is unable to avoid the transfer of a lease as a bona fide purchaser under section 544(a)(3), the trustee may attempt to avoid the transfer under section 544(a)(1) and (2), which gives the trustee the position of a judicial lien creditor and execution creditor. The oil and gas lease is personal property not subject to a judgment lien under Oklahoma statutes, but on execution a lien can be established by the judgment creditor against the personal property of the debtor.

It has been well established in Oklahoma that a judgment lien and execution only attach to the actual interest owned by the debtor in the estate. Therefore, the trustee as execution and judgment creditor probably cannot avoid an unrecorded

197. Continental Supply Co. v. Marshall, 152 F.2d 300, 305 (10th Cir. 1945).
200. Id.; see also Frye v. Farmers & Merchants Bank of Cape Girardeau, 561 S.W.2d 392 (Mo. App. 1977).
interest of a leasehold under these provisions.\textsuperscript{202} Secondly, the Oklahoma recording statutes exist to protect bona fide purchasers and creditors, not judicial lien holders, so the status of record title is irrelevant to the trustee's claims as a judicial or execution lien creditor.\textsuperscript{203} Section 544(a)(1) and (2), like section 544(a)(3), therefore probably will not allow the trustee to avoid the transfer. This means that the holder of an unrecorded mineral leasehold interest in Oklahoma should be able to successfully assert that interest against judgment creditors and the trustee in bankruptcy. Interestingly, while not considered real property, the mineral leasehold interest is also excluded from the rules governing personal property security interests by section 9-104(j) of the Uniform Commercial Code. As a consequence, the unrecorded mineral leasehold interest is apparently safe from attack by judgment liens, a trustee in bankruptcy, and Uniform Commercial Code security interests, surely an enviable and unusual situation.

Section 541(d) provides that the property of the estate shall not include property in which the debtor holds only legal title and has no equitable interest. Again, this should exempt an unrecorded leasehold interest from the trustee's grasp. The courts, in construing sections 544(a)(3) and 541(d), have indicated that section 544(a)(3) supplements the provisions of section 541(d), and even if the debtor has no interests in the property subject to the transaction attempted to be avoided, section 544(a)(3) can bring into the estate any property the trustee can obtain through his hypothetical bona fide purchaser status.\textsuperscript{204} As noted, however, the trustee's section 544(a)(3) power only goes to real property and therefore should be unavailing as to personal property such as a lease.

An unrecorded grantee may also claim that a constructive trust exists in his favor, thereby defeating the hypothetical lien creditor status of the trustee. Property which is held in trust may not be considered a part of the debtor's estate. In \textit{In re Mahan & Rowsey, Inc.},\textsuperscript{205} overriding royalty interests were to be assigned to a consulting geologist who developed

\begin{flushright}
203. Buell Cabinet Co. v. Sudduth, 608 F.2d 431 (10th Cir. 1979).
\end{flushright}
prospects for the debtor. The agreement to assign the override was not executed by the debtor, nor were any overriding royalty interest assignments recorded. The court held that the evidence was unequivocal and decided that a constructive trust existed to the extent of the override and therefore the override did not become part of the estate.

If the property becomes part of the estate, under Oklahoma law the trustee as hypothetical unsatisfied execution and judicial lien creditor will have rights inferior to the resulting or constructive trust. Recent Oklahoma cases have established constructive trusts for the payment of proceeds, for the overpayment of joint interest billings, and for the non-payment of overriding royalties. Should the trustee avoid the transfer of an unrecorded farmout or overriding royalty interest under section 544(a), a constructive trust may be a method for the grantee to retain its interest in the leasehold.

IV. COMMON LAW AND STATUTORY LIENS FOR WORK PERFORMED

A. In General

Common law and statutory possessory liens for work done on or to personal property collateral, another possible exception to the first-in-time rule, have priority over any security interest, regardless of the time of perfection, as long as the lienor retains possession of the collateral. Examples could include a laborer's, repairman's, artisan's, carrier's, or storage lien.

Mechanics' and materialmen's liens filed by a general contractor within four months after the date upon which ma-

207. Reserve Oil, Inc. v. Dixon, 711 F.2d 951 (10th Cir. 1983).
terial, equipment or labor was last furnished to the project will relate back to the date that work was first begun on the project for purposes of priority. 212 A materialman or subcontractor who furnishes material, equipment, or labor to the contractor for the project has until ninety days after the last material, equipment, or labor was furnished to file a lien statement, with the same results. 213 Until recently, these filing periods were applicable to creditors asserting a statutory oil and gas lien, but because of difficulties in determining whether a party was a contractor or subcontractor, the Oklahoma legislature recently amended the filing period to perfect the statutory oil and gas lien. Under the statute as amended, both the contractor and subcontractor have 120 days after the date the materials or labor were supplied to a well to file a lien statement. 214

Lien statements filed within these time periods relate back, or attach, to the subject property as of the first date that anyone furnished labor, materials, or equipment for the project, thereby giving the lien claimant priority over any other creditor whose priority dates from a later time. To avoid subordination of their interests to mechanics’ and materialmen’s liens, construction lenders must take special care to document the existence of the construction mortgage lien prior to commencement of any work on the project, and must ensure that the construction loan payouts, or future advances, are obligatory. 215

B. The Statutory Oil and Gas Lien

Because the statutory oil and gas lien is in derogation of the common law, the Oklahoma courts have required that they be strictly construed. 216 The oil and gas lien is created by

213. Id. at § 143.
216. Republic Bank & Trust Co. v. Bohmar Minerals, Inc., 661 P.2d 521 (Okla. 1983). Texas law also strictly construes the statutory provisions for a materialman’s lien. In In re Clear Fork Energy Resources, 44 Bankr. 110 (Bankr. N.D. Tex. 1984), a lien was held invalid because it contained an acknowledgment and not a jurat, and
statute, and the language of that statute limits the scope of
the lien beyond which it cannot be extended.217 Once a lien
has been properly filed in Oklahoma, the courts will allow it to
be liberally enforced and amended. Before it is filed, however,
the courts will strictly construe the statute.218

In order to create a valid oil and gas lien, a lien statement
must be filed with the county clerk in the manner provided by
the state statute.219 The lien statement must be filed within
120 days from the date the work was last performed or the
goods were last supplied to the leasehold.220 The oil and gas
lien must contain the following information: (1) a statement
setting forth the amount claimed and identifying the material
or labor supplied; (2) the name of the owner or owners of the
property against which the lien is being claimed; (3) the name
of the contractor; (4) the name of the lien claimant; (5) the
description of the property subject to the lien; and (6) a verifi-
cation of the lien by affidavit.221

The statute specifically exempts bona fide royalty inter-
ests, production payments, and overriding royalty interests
from the scope of the statutory lien.222 The overriding royalty
should be recorded promptly, however, or it may be subject to
the statutory lien.223 In Zone Oil & Gas v. Dudley & Heath
Drilling Co.,224 Zone had oil and gas leases of record, and as-
signed these leases to a second party who intended to deepen
an existing well, reserving a production payment. The second
party who obtained the assignment hired Dudley & Heath
Drilling Company to deepen and complete the subject well.
After the completion of the well, Zone recorded its assignment
and its reservation of the production payment. Due to non-

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therefore did not satisfy the statutory requirement that the lien must be accom-
panied by "a statement verified by affidavit." Id. at 112.


218. Id.

1984).


221. Id.

222. Id.

1970).

224. Id.
tempted to foreclose. The Oklahoma Supreme Court held that Dudley & Heath had no notice of the production payment reserved by Zone because it was not of record, and that such production payment was therefore subject to the statutory lien.\textsuperscript{226}

The names of the interest owners must be listed on the lien statement in order for the lien to be valid.\textsuperscript{226} Failure to list the names of the owners does not invalidate the entire lien; it only invalidates the ability to assert the lien against the unnamed owners. When a number of wells are to be drilled on the leasehold, a separate lien should be filed on each well.\textsuperscript{227} For this reason the debtor should try to arrange his accounting and billing procedures to itemize the services or materials supplied on a well-by-well basis.

Recent legislation provides that an oil and gas lien does not have to comply with the statutory requirements regarding the formalities of execution of instruments regarding real estate.\textsuperscript{228} Prior to this time there was a question as to whether oil and gas liens not executed by corporate officers could be enforced.\textsuperscript{228} Once the lien statement has been filed with the county clerk, the county clerk will mail notice to the owners of the property that a lien has been filed against their interests.\textsuperscript{229} With regard to the proceeds from production, the lien is ineffective against the purchaser until notice of the lien is mailed to the purchaser by certified mail.\textsuperscript{231}

After an oil and gas lien has been filed, it may be amended by leave of court in the furtherance of justice, except as to the amount claimed and the parties named in the lien statement.\textsuperscript{232} The Oklahoma courts have expressed a liberal

\textsuperscript{225} \textit{Id.} at 399.


\textsuperscript{231} \textit{Id.} at § 144.1.

\textsuperscript{232} \textit{Id.} at § 172.
philosophy with respect to amendments such as a correction of the legal description,\textsuperscript{233} addition of an itemized list of material furnished by claimant,\textsuperscript{234} or addition of a verification of lien statement.\textsuperscript{235}

Unlike most liens which follow the first-in-time, first-in-right rule with regard to recording and priority, the statutory oil and gas lien attaches to the subject property as of the date the material was \textit{first} furnished or the work was \textit{first} performed on the leasehold.\textsuperscript{236} The statutory lienholder can achieve a priority status which relates back to the date the material was first supplied by perfecting his lien by filing the lien statement of record. The intent of the legislature when enacting the oil and gas lien statute was to grant priority status to materialmen who supplied labor or materials for the drilling of the well.\textsuperscript{237} The Oklahoma Supreme Court has stated that:

\begin{quote}
The provisions of the Mechanics' Lien Law should be interpreted so as to carry out the object had in view by the Legislature in enacting it, namely, the security of the classes of persons named in the act, upon its provisions being in good faith substantially complied with on their part.\textsuperscript{238}
\end{quote}

The court has further noted that when the lien "was enacted by the Legislature of Oklahoma Territory, in 1905 . . . [i]t had already become apparent . . . that the general lien was inadequate to protect the laborer and materialman in their right of compensation for service rendered and materials furnished in the further development of this natural resource [oil and gas]."\textsuperscript{239}

When the debtor is in bankruptcy, the automatic stay prevents a creditor from pursuing "any act to create, perfect, or enforce any lien against property of the estate."\textsuperscript{240} The

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\item \textsuperscript{233} El Reno Elec. Light & Tel. Co. v. Jennison, 5 Okla. 759, 50 P. 144 (1897).
\item \textsuperscript{234} \textit{Id.}; Key v. Hill, 93 Okla. 64, 219 P. 308 (1923).
\item \textsuperscript{235} Jennison, 5 Okla. at 759, 50 P. at 144.
\item \textsuperscript{236} Okla. Stat. tit. 42, § 144 (1981).
\item \textsuperscript{237} \textit{In re} Mahan & Rowsey, 27 Bankr. 883, 885 (Bankr. W.D. Okla. 1983).
\item \textsuperscript{238} Oklahoma Tool & Supply Co. v. Smith, 118 Okla. 228, 230, 246 P. 1090, 1091 (1926) (quoting Eberle v. Drennan, 40 Okla. 59, 136 P. 162 (1913)).
\item \textsuperscript{239} William M. Graham Oil & Gas Co. v. Oil Well Supply Co., 128 Okla. 201, 209, 264 P. 591, 598 (1927).
\item \textsuperscript{240} 11 U.S.C.A. § 362(a)(4) (West Supp. 1985).
\end{itemize}
statutory lien may fall outside this provision when the applicable state law permits perfection of an interest in property retroactively, and the trustee will take subject to the creditor's right to so perfect if such perfection is done in accordance with the statute.\textsuperscript{241} It is well established that filing a lien after the debtor has filed for bankruptcy is permitted so long as the lien relates back to the date materials were furnished before the debtor went into bankruptcy, and the filing of the lien is carried out within the time prescribed in the state mechanic lien statutes.\textsuperscript{242}

C. Extent of the Statutory Lien

The court cannot create a statutory lien on equitable grounds, because the language of the statute limits the extent of the statutory lien.\textsuperscript{243} For example, in \textit{Taylor v. B. B. & G. Oil Co.}\textsuperscript{244} the plaintiffs removed and cleaned a portion of defendant's pipeline, filled the trench with dirt, and serviced the pipe so that the pipe could be of use elsewhere. After filing an oil and gas lien under the statute, the plaintiff attempted to foreclose. The \textit{Taylor} court held that the activities did not involve the digging, drilling, torpedoing, operating, completing or repairing of any specific well or leasehold, and were not covered by the oil and gas lien statute. Therefore an oil and gas lien under the statute was not available, regardless of the equitable circumstances involved.

The court has held that the following activities can create a valid oil and gas lien under the statutory language: (1) pulling casing, tubing, and rods from a well;\textsuperscript{245} (2) repairing engines to be used for drilling;\textsuperscript{246} (3) supplying "fishing" tools to a well in an attempt to recover equipment;\textsuperscript{247} (4) supplying a drilling rig and equipment;\textsuperscript{248} or (5) hauling materials to the

\textsuperscript{242} Marietta Baptist Tabernacle, Inc. v. Tomberlin Assoc., Architects, Inc., 576 F.2d 1237 (5th Cir. 1978); Poly Indus., Inc. v. Mozley, 362 F.2d 453 (9th Cir. 1976), cert. denied, 385 U.S. 958 (1967).
\textsuperscript{243} Riffe Petroleum Co., 614 P.2d at 576; Mahan & Rousey, 27 Bankr. at 833.
\textsuperscript{244} 207 Okla. 288, 249 P.2d 430 (1952).
\textsuperscript{245} Indo Oil Co. v. Bennett, 202 Okla. 300, 213 P.2d 546 (1949).
\textsuperscript{246} Nemeroff v. Cornelson Engine Maintenance Co., 369 P.2d 604 (Okla. 1962).
\textsuperscript{247} William M. Graham Oil & Gas Co., 128 Okla. at 201, 264 P. at 591.
\textsuperscript{248} Schraeder v. Gormley, 127 Okla. 76, 259 P. 869 (1927).
drillsite. Once the claimant has brought himself within the confines of the statute, the Oklahoma courts have generously provided a remedy to the lien claimant. Prior to this time, the lien statute is strictly construed. 

Because of the strict construction of the statute, the ability of an attorney to assert a lien under the statutory provisions for professional services has been questioned. In 1963, the Oklahoma legislature added the provision that a statutory lien could be asserted if there were “written contracts for the services of a geologist or petroleum engineer.” It has been argued that these provisions can be construed as a legislative endorsement of the availability of the statutory lien to any professional services rendered.

The issue of whether an attorney can assert a statutory lien was recently decided in the Bankruptcy Court for the Western District of Oklahoma in In re Bunker Exploration Co. In Bunker, an attorney prepared a division order title opinion and billed the debtor for the costs incurred in preparing the opinion. Payment was not received, and the attorney filed a statutory lien against the well. The attorney subsequently filed a petition for relief, claiming that absent a title opinion the well was not complete, and that the production could not be sold nor could the well be operated without the title opinion. The attorney claimed that his services were provided in accordance with the provisions of the statute, and that a statutory lien should be available. The court in Bunker held that the attorney “predicated its argument on equitable principles,” and that when the legislature amended the statutory language to include geologists or petroleum engineers, they also would have included attorneys if it was their intent to allow an attorney to claim a lien under the statute. The attorney’s claim under the statutory oil and gas lien was therefore denied.

251. See Note, Oklahoma’s Oil and Gas Well Lien Statute: Should It Be Extended to Attorneys and Other Professionals?, 36 Okla. L. Rev. 401 (1983).
254. Id. at 710.
255. Id. at 711.
D. Judgment and Enforcement

Before a material supplier or laborer can obtain a judgment and enforce a lien against the owner's property, he must file a lien statement naming each owner against whom judgment is requested. If an owner is not named in the lien statement, the lien is not perfected against that interest, and any judgment of foreclosure entered against the unnamed owner is invalid. Failure to name an owner, however, does not invalidate the entire lien.

A number of different theories have been advanced by creditors in attempting to enforce the lien against parties who are unnamed in the lien statements. When one or more parties voluntarily agree to drill a well and appoint an operator to manage and control the activities, the relationship between the parties under Oklahoma law is that of joint adventurers unless modified by contract. The lien claimant in the case of *In re Mahan & Rowsey* argued that the well operator was acting as an agent for all of the working interest owners and, therefore, an oil and gas lien naming only the operator would be valid against all working interest owners under agency law. The court held that the parties had signed a 1977 A.A.P.L. Model Form Operating Agreement which expressly negated an agency relationship.

Absent a Model Form Operating Agreement, a court might find that the operator was acting as an agent for the working interest owners; therefore, the naming of the operator would be sufficient to foreclose the interest of the other working interest owners. To avoid such a result, a party voluntarily participating in the development of a lease should specify in the Operating Agreement or development contract that the parties are in a co-tenant relationship rather than a partnership or joint adventure.

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260. *Id.* at 885.
261. *Id.* at 886.
The Oklahoma Supreme Court held in *Uncle Sam Oil Co. v. Richards* that an operator as a co-tenant cannot file a statutory lien against a non-operating co-tenant in a well.\(^{262}\) If the well was drilled under an operating agreement, such as the A.A.P.L. Model Form Operating Agreement, the operator would have a contractual lien against the non-operating co-tenants, but could not enforce a statutory lien. In *Uncle Sam*,\(^{263}\) the partners were functioning under an oral contract and not under an A.A.P.L. Model Form Operating Agreement. The operator, under the Model Form Operating Agreement, functions more in the nature of an independent general contractor and has exclusive control over operations on the leasehold.\(^{264}\) Due to this distinction, the operator should be allowed to file a statutory lien. The Bankruptcy Court for the Western District of Oklahoma, however, has recently affirmed the holding to the contrary in the *Uncle Sam* decision.\(^{265}\)

All other lien claimants must be made parties and, if the action is brought by a subcontractor, the original contractor must also be named.\(^{266}\) This often presents a problem if the original contractor, or operator, is in bankruptcy and thus cannot be made a party because of the automatic stay under the United States Bankruptcy Code.\(^{267}\) Relief from the stay may be obtained, often for the limited purpose of naming and serving the operator. If the contractor cannot be found, however, the action may proceed in its absence.\(^{268}\)

The practice, pleading, and procedure of the statutory lien foreclosure action conforms to the rules prescribed by the Code of Civil Procedure as far as it is applicable.\(^{269}\) The action to foreclose must be brought within one year from the date

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263. *Id.* A joint adventure is a relationship formed for a specific purpose and for a limited time, and the law of partnership applies. 2 H. Williams & C. Meyers, Oil and Gas Law § 437 (1984).
264. Under the 1977 A.A.P.L. Model Form Operating Agreement, the operator has "full control of all operations" on the leasehold, and can employ "its own tools and equipment in the drilling of wells" or can contract for such services.
269. *Id.* at § 172.
that the lien is filed and should be brought in the district court of the county where the land is situated.\textsuperscript{270} As discussed above, the lien statement may be amended by leave of court in the furtherance of justice, as pleadings may be in any matter, although the statutes specifically prohibit amendment as to the amount claimed.\textsuperscript{271} Claimants cannot amend the statement of lien to claim new interests against the property, because amendments setting up new causes of action are not allowed after the expiration of the statutory limit for commencing action on such claim.\textsuperscript{272}

The foreclosure action is required to be brought within one year of the filing of the statutory lien with the county clerk.\textsuperscript{273} The statute of limitations in an action to foreclose on a mechanics' and materialmen's lien begins to run upon the filing of the lien. The timely filing of the lien statement is necessary to impress a mechanics' and materialmen's lien against the property, and is a critical step in the proceedings.\textsuperscript{274}

Materialmen's liens are governed by the limitations period which is effective when the lien statement is filed.\textsuperscript{275} In \textit{First National Bank of Pauls Valley v. Crudup},\textsuperscript{276} a statement of lien with an unmatured promissory note attached was timely filed. Under the 1972 version of title 42, section 172 of the Oklahoma Statutes, which is different from the statute in effect today, the one year statute of limitations began to run against the lien claim from: (1) the time for filing of the lien with the court clerk; or (2) from the maturity of the attached note.\textsuperscript{277} The court ruled that although the foreclosure action was not filed within the one year period after the filing of the lien, the lien was not extinguished because the foreclosure action was commenced within one year after the maturity date of the promissory note attached to the lien. If the present

\textsuperscript{270} \textit{Id.}; see also \textit{Okla. Stat. tit. 12, § 131 (1981).}
\textsuperscript{271} \textit{Okla. Stat. tit. 42, § 172 (1981).}
\textsuperscript{272} \textit{Culver v. Mid-Continent Casualty Co.}, 526 P.2d 496, 498-99 (Okla. 1974).
\textsuperscript{273} \textit{Okla. Stat. tit. 42, § 172 (1981).}
\textsuperscript{275} \textit{Crudup}, 656 P.2d at 917.
\textsuperscript{276} \textit{Id.} at 914.
\textsuperscript{277} \textit{Id.} at 915.
statute had been applicable in *First National Bank of Pauls Valley*, the lien would have been extinguished because of the failure of the lien claimant to commence the foreclosure action within one year of the date of filing of the lien.

Foreclosures of materialmen's liens are a matter of equitable cognizance which are not triable to a jury. If personal judgment is sought against one or more owners, however, under a contract theory or some other theory of third party liability, and the amount owed is in dispute, then the indebtedness due becomes an issue to be tried to a jury as a matter of right.

The Oklahoma Supreme Court has held that the statutory oil and gas lien extends only to the leasehold interest of the debtor, and that no personal judgment may be taken against any of the working interest parties unless they are in a partnership with the party who contracted for the materials. The oil and gas lien attaches only to the leasehold interest and the equipment thereon; therefore any judgment in excess of the value of the leasehold or equipment on which the lien has attached must be brought in a separate contract cause of action against the parties to the contract. The party foreclosing a valid lien is entitled to the principal amount under the lien, interest, and reasonable attorney's fees.

Because an oil and gas lease creates an interest in real property but is not *per se* real estate, the question arises as to whether the oil and gas lease must be sold as realty, with appropriate notices, appraisements, and sale at two-thirds of the appraised value. This issue was discussed in a recent opinion of the Oklahoma Supreme Court, *Archon Oil Co. v.*

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278. Id. at 917.
282. See *McAnally*, 170 Okla. at 368, 46 P.2d at 955.
Cate,\textsuperscript{287} and was analyzed elsewhere in this paper.\textsuperscript{288} Prudence would suggest, insofar as possible, treating the oil and gas lease as realty and following the statutory and sale requirements.

\section{E. Discharge}

A mineral owner may discharge a mechanics’ and materialmen’s lien by depositing a cash or surety bond equal to one hundred twenty-five percent of the amount claimed with the county clerk.\textsuperscript{289} If cash is deposited with the county clerk, the claimant must proceed against the substituted security in the same time and manner as required for the foreclosure of a lien claim.\textsuperscript{290} This procedure enables the mineral owner to immediately release a lien filed against his property prior to the determination of the amount owed under the lien and avoids suspension of the purchaser’s payments to the owner because of the lien. If a bond is deposited, the county clerk will release the lien after ten days if the claimant does not file an objection to the bond.\textsuperscript{291}

\section{V. Contractual Oil and Gas Lien Under the A.A.P.L.
Model Form Operating Agreement}

The Model Form Operating Agreement was created in response to the need of the energy industry for a standard agreement designating the rights and duties of the parties in the development of an oil and gas leasehold.\textsuperscript{292} Prior to the advent of the Model Form Operating Agreement, the operating agreement was negotiated on a well-by-well basis, slowing development as the parties negotiated and reviewed the terms of such agreements. The A.A.P.L. Form 610-1977 and the A.A.P.L. Form 610-1982 Model Form Operating Agreements have emerged as the primary contracts governing the joint development of oil and gas leasehold interests in Oklahoma.

\begin{itemize}
\item \textsuperscript{287} 56 Okla. B.J. 453 (Feb. 23, 1985).
\item \textsuperscript{288} See supra notes 162-66 and accompanying text.
\item \textsuperscript{289} Okla. Stat. tit. 12, § 147.1 (Supp. 1982).
\item \textsuperscript{290} Id.
\item \textsuperscript{291} Id.
\end{itemize}
Under both the A.A.P.L. Form 610-1977 and the A.A.P.L. Form 610-1982 Model Form Operating Agreements each non-operator in a well grants a consensual lien to the designated operator. The statutes recognize that a lien can be created by contract or by statute. Such lien provisions in the 1977 version are as follows:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and/or gas when extracted and its interest in all equipment . . . In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and/or gas until the amount owed by such Non-Operator, plus interest, has been paid.

The consensual lien under the operating agreement deals with two distinct types of property, and thus two types of potential security interests are created. One potential security interest would occur in realty, and one potential security interest would occur in the personal property. The lien granted under the operating agreement includes a claim against the "oil and gas rights in the contract area," as well as a claim to the oil and gas "when extracted." Oil and gas rights in the contract area would include an interest in the leasehold subject to the operating agreement. It has been consistently held in Oklahoma that although oil and gas creates an interest in realty, the interest is not per se real estate. One commentator has listed the possible classification of leasehold interest in various states:

a profit a prendre, a corporeal hereditament, an incorporeal hereditament, an estate in land, not an estate in land an estate in oil and gas, not an estate in oil and gas, a servitude, a chattel real, real estate, interest in land, not an interest in land, personal property, a freehold, a tenancy at will, prop-

294. Article VII(B). The lien provisions under the 1982 version are substantially identical.
property interest, and the relation of landlord and tenant.\textsuperscript{296}

In general, once extracted, minerals may be considered personal property if they are reduced to possession.\textsuperscript{297} In Oklahoma, oil and gas in its natural state is not susceptible to ownership in place before extraction, and the right to explore and acquire title to oil and gas has been classified as an incorporeal hereditament or a \textit{profit a prendre}.\textsuperscript{298} To the extent that they are personal property, the severed oil and gas or the associated proceeds may be subject to the provisions of the Uniform Commercial Code.\textsuperscript{299} A number of courts have held that the sale and purchase of extracted natural gas, as well as the terms of gas purchase contracts, will be interpreted and governed by the Code.\textsuperscript{300} Another court has held that the sale of crude oil is the sale of goods, and therefore is subject to the provisions of the Code.\textsuperscript{301}

To the extent the operating agreement grants the operator rights in personal property, these rights may be secured under article 9 of the Uniform Commercial Code.\textsuperscript{302} Due to the consensual nature of the operating agreement lien, and the intent of the parties to grant a security interest, the operating agreement would constitute a security agreement between the debtor (non-operator) and creditor (operator). In order for the security interest to attach, three factors must be present: (1) the debtor must have signed the operating agreement which contains the consensual lien and a description of the well and contract area; (2) value must have been given by the secured party operator; and (3) the debtor must have

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\textsuperscript{297} Replogle v. Indian Territory Illuminating Oil Co., 193 Okla. 361, 143 P.2d 1002 (1943); White v. McVey, 168 Okla. 19, 31 P.2d 850 (1934).
\textsuperscript{301} Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).
\textsuperscript{302} Even though extracted, oil and gas products and proceeds from such products retain, in some contexts, attributes of reality, while in other contexts, the law of personality would apply. Continental Supply Co. v. Marshall, 152 F.2d 300 (10th Cir. 1945); 1 H. Williams & C. Meyers, \textit{Oil & Gas Law} § 212 (1984).
\end{flushleft}
rights in the collateral or leasehold in the unit. The operator gives value by agreeing to bear the responsibility for the drilling and management for the exploration operations. The non-operator has rights as the working interest owner in the collateral; otherwise, he would not be a signatory party to the operating agreement. The operating agreement thus meets the requirements of the Oklahoma statutes for establishing a valid security interest under article 9 of the Uniform Commercial Code.

Although the security interest attaches between the operator and non-operator, making the agreement enforceable between these parties, under the Code the security interest must be perfected in order to make it enforceable against the world. "Attachment" essentially means that there is a valid contract between the parties; once the agreement is "perfected" that contract is enforceable as against third parties. When the collateral is timber or minerals, including oil and gas, or accounts, then the proper place to perfect a security interest is by filing in the office where a mortgage on the real estate would be perfected. In the case of oil or gas, or associated proceeds, this would be where the wellhead is located. When a mortgage has been recorded in the office of the county clerk where the oil and gas leasehold interests are located, or on equipment used to mine or process the minerals, then the mortgage shall constitute a valid financing statement.

In order to perfect the security interest, the operating agreement itself or a financing statement should be recorded. This will allow the operator, as a secured party, to gain priority over subsequently filed security interests covering the same collateral. A number of oil and gas commentators have suggested that the operating agreement should be filed as a financing statement to perfect the operator’s security interest. Under the Code, a financing statement must contain the following information: (1) the identity of the debtor; (2) the identity of the secured party; (3) the address of the secured party; (4) the address of the debtor; and (5) a description of

the items of collateral covered by the security agreement, signed by the debtor.\footnote{306}

In most instances the operating agreement contains enough information to be sufficient to serve as a financing statement. Because it is not acknowledged in most instances, it would be difficult to record an operating agreement. The recording of a lengthy operating agreement with exhibits and signatory pages would also be somewhat burdensome and expensive. As an alternative to filing the entire operating agreement, the operator may choose to file a short memorandum of operating agreement to serve as a financing statement. The memorandum of operating agreement must contain the above named requirements, and should be acknowledged so that it can be recorded. The memorandum of operating agreement, if it contains a summary of the provisions of the operating agreement, should be just as effective as recording the operating agreement itself with regard to alerting potential purchasers, creditors, or title attorneys to the existence of the consensual lien.

In addition to the perfection of the security interest by the recording of an operating agreement or memorandum of operating agreement, perfection may be accomplished by the possession or physical control of the severed oil and gas, or the oil and gas proceeds.\footnote{307} While the Uniform Commercial Code allows a party attempting to perfect in this manner to take possession of the collateral so long as it does not involve a breach of the peace, that same party should also be aware that assignments of profits from realty, intended to become effective upon future default, are unenforceable in Oklahoma as contrary to public policy. Such assignments are viewed by the Oklahoma Supreme Court as a restraint on the mortgagor's right of redemption.\footnote{308}

If the operator drills a dry hole, or if technical difficulties prevent the operator from completing a promising well as a producer, the operator will be in a less desirable position with regard to its ability to assert a valid lien against the leasehold.

\footnote{306. \textit{Id.} at § 9-402.}
Under existing case law, the operator may be precluded from filing a statutory oil and gas lien against the non-operator co-tenants in the well.\textsuperscript{309} Because the leasehold is not \textit{per se} real estate, and because the operating agreement is technically not a mortgage, the right of the operator to foreclose on the leasehold estate may not be entirely clear.

The parties to an operating agreement should also be aware that they may be liable for their share of the costs which are not paid by the defaulting parties. The 1977 version provides:

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.\textsuperscript{310}

This right of the operator to recover a proportionate share of the costs, commonly known as the "spread right," is often deleted from the operating agreement by the signatory parties due to the liabilities which may be incurred. Under the spread right provision, a party can pay all of its proportionate share of the cost of a well, yet still have a lien filed against its interests by the operator for the defaulting party's share of the costs.

\section*{VI. Other Laborer's Liens}

Anyone who furnishes labor, money, material, or supplies for production, alteration, or repair of personal property at the request of the owner will have a lien on the property dating from commencement of the activity.\textsuperscript{311} This lien is waived unless a lien statement is filed within sixty days of the last such activity,\textsuperscript{312} and is subordinate to a prior mortgage lien.

\begin{footnotes}
\item[309] Uncle Sam Oil Co. v. Richards, 60 Okla. 63, 158 P. 1187 (1916).
\item[310] Article VII(B) (the provisions of the 1982 form are substantially similar).
\item[311] \textsc{Okla. Stat.} tit. 42, § 97 (1981).
\item[312] \textit{Id.} at § 98.
\end{footnotes}
unless the mortgagee has prior notice and consents to the alteration or repair.\textsuperscript{313}

In some ways, the strongest laborer's lien statute of all is title 42, section 92, of the Oklahoma Statutes. This provides a laborer's lien for any work done under a verbal or written contract. This lien has priority over any and all other liens, regardless of the time of recording or perfection,\textsuperscript{314} but ceases to exist if the property is sold.\textsuperscript{315} This lien is available only to "menial workers" who perform "manual labor with their own hands for daily wages." It is not available to an independent contractor who, for example, clears the ground with a bulldozer or uses other heavy power equipment. But once applicable this lien has priority over all competing liens and secured claims regardless of the dates the work was commenced or the liens were obtained.\textsuperscript{316}

Although section 92 states that "such lien shall attach only while title to the property remains in the original owner," other factors may prevent termination of the lien upon disposition of the property.\textsuperscript{317} Estoppel may prevent termination where the disposition is wrongful.\textsuperscript{318} An effort to file a lien statement for purposes of claiming a mechanics' and materialmen's lien under title 42, sections 141 and 142 of the Oklahoma Statutes does not preclude the laborer from additionally claiming a laborer's lien under section 92.\textsuperscript{319}

VII. OTHER COMMON LAW AND STATUTORY LIENS

Generally, non-possessory common law and statutory liens are not favored by the law due to their "secret," unrecorded status and the resultant lack of notice to other parties. They are generally subordinated to any competing, perfected security interest or mortgage. In addition, section 544(a)(3) of

\textsuperscript{313} Id. at § 99.
\textsuperscript{314} Id. at § 96.
\textsuperscript{315} Id. at § 92.
\textsuperscript{318} See Williamson v. Winningham, 199 Okla. 393, 186 P.2d 644 (1947).
\textsuperscript{319} Morley v. McCaskey, 134 Okla. 65, 272 P. 850 (1929); Morley v. McCaskey, 134 Okla. 50, 270 P. 1107 (1928).
the Bankruptcy Code\textsuperscript{320} gives the trustee the powers of a bona\linebreak fide purchaser of real estate, effectively permitting avoidance\linebreak of many non-possessory statutory and common law liens in\linebreak bankruptcy. Certain statutory liens are also specifically sub-
ject to avoidance by the trustee under section 545 of the Bankruptcy Code.
For example, a landlord's lien is typically subordinated to a prior perfected security interest.\textsuperscript{321} In Oklahoma, the statute creating the landlord's lien provides that it shall be subordi-
ate to a prior chattel mortgage.\textsuperscript{322} Courts in some states, however, have held that a landlord's lien prevails over subsequent security interests, and at least one court has held that priority of a landlord's lien dates from the beginning of the tenancy or the date the chattel is brought on the premises, even though the rent default occurs after the intervening lien has been perfected.\textsuperscript{323}
Agricultural liens are another example. The Oklahoma general lien statutes contain a number of liens with potential application in the agricultural context. There are also several liens with specific agricultural applications.\textsuperscript{324}

\textsuperscript{321} See e.g., Briggs v. Thompson, 287 Or. 233, 598 P.2d 296 (1979). Landlord's liens are specifically subject to avoidance in bankruptcy under section 545 of the Bankruptcy Code.
\textsuperscript{323} United States v. S.K.A. Assoc. Inc., 600 F.2d 513 (5th Cir. 1979); see also Annot., 99 A.L.R. 3d 1006 (1980).
\textsuperscript{324} Title 4, sections 191, 192 and 193 of the Oklahoma Statutes provide as follows:

Section 191. Lien for feeding, grazing and herding
Any person employed in feeding, grazing or herding any domestic ani-
imals, whether in pasture or otherwise, shall have a lien on said animals for the amount due for such feeding, grazing or herding.

Section 192. Lien for furnishing feed
Any person, partnership, firm or corporation in this state, or in any border county of the adjacent states, furnishing or providing to the owner of such domestic animals any corn, feed, forage or hay, for the sustenance of such domestic animals, shall have a lien on said animals for the amount due for such corn, forage, feed and hay.

Section 193. Lien for keeping, boarding or training animal — Scope.
Every person who shall keep, board or train any animal, shall, for the amount due therefor, have a lien on such animal, and on any vehicle, harness or equipment coming into his possession therewith, and no owner or claimant shall have the right to take any such property out of the custody
should continue to be subordinate to perfected security interests, based on Leger Mill Co. v. Kleen-Leen, Inc. In that case Leger Mill furnished the feed to the debtor under an arrangement that pre-dated the perfection of the competing security interest. The feedman alleged that since he was first-in-time with his feedman’s lien he should be first-in-right. The court disagreed:

The narrow issue presented for our determination is whether these statutory liens take priority over security interests properly perfected under the Uniform Commercial Code. . . .

Both feedmen rely upon the fact that they began supplying feed to Scarbrough before the Bank perfected its security interest in September, 1970. Being first in time, they argue, they are entitled to priority.

Bank had no knowledge or notice of the claims of the feedmen when its security interest was perfected. Bank argues that these non-possessory liens are “secret” liens which are not favored by the law and that they cannot take priority over security interest, even where they are first-in-time, when the security interest was acquired by a third party who took without notice.

We agree. We have previously passed upon the priority of undisclosed non-possessory liens on animals asserted as prior to later recorded mortgage interests.

As to the claim that the secured creditors had implicitly consented to priority of the feedman’s liens:

The mere knowledge of a mortgagee that feed is being supplied to mortgagor’s animals by a certain seller is not, without more, sufficient. Fletcher v. Bank of Meeker, Okla., 376 P.2d 263 (1962). Nor is it sufficient, without more, that mortgagee consented to or approved of the source from which mortgagor obtained the feed.

The criteria of the exception are not met simply because mortgagee knows the mortgaged animals are eating.

of the person having such lien, except with his consent, or on the payment of such charge; and such lien shall be valid against said property in the possession of any person receiving or purchasing it with notice of such claim.

326. Id. at 135, 138.
Everyone knows that animals eat and further, that food for them must be obtained from some source.

The knowledge and consent exception which will allow a subsequent lien holder to prevail over a previous recorded mortgage is dependent upon two essentials. First, upon mortgagee’s knowledge that feed is being, or will be, supplied at the expense of the feeder, and second, upon mortgagee’s promises or actions which induce feeder to supply feed to his detriment, based upon the belief that mortgagee has consented to the arrangement and will hold him harmless. 327

Title 42, section 119 of the Oklahoma Statutes, however, provides for a thresher’s or combiner’s lien against grain or seed threshed or combined, and makes any lienor or mortgagee equally responsible with the owner for the threshing/combing bill to the extent that the lienor/mortgagee takes possession of any grain or seed. 328

A statutory, possessory lien for materials or services provided, which qualifies under section 9-310 of the Uniform Commercial Code will prevail over any competing security interest, regardless of the date of perfection. For example, section 191 and section 193 liens might qualify if the lienor retains possession. A statutory, possessory artisan’s lien is entitled to priority over a prior, perfected security interest, but only if and so long as the lienor retains possession of the collateral. 329 The same applies to a repairman’s lien. 330 Perhaps the lien most likely to be encountered in conjunction with section 9-310 of the Uniform Commercial Code is the warehouseman’s lien. Section 7-209 of the Code provides the warehouseman a statutory, possessory lien on stored crops or other property to secure unpaid storage charges. This together with section 9-310 of the Code would give priority to the warehouseman as to storage charges. In a Kansas case the court extended this lien beyond storage charges to “unpaid open accounts for fertilizer, insecticides and herbicides . . .

327. Id. at 137.
used to produce the crop." This lien was found to qualify for priority over previous security interests under section 9-310 of the Uniform Commercial Code. In Oklahoma, a lien for storage under title 42, section 91 of the Oklahoma Statutes is given priority over a perfected security interest pursuant to section 9-310 of the Uniform Commercial Code.

VIII. MINING PARTNERS LIENS

Under Oklahoma law, where there is common ownership but no joint development of property, the parties are in a tenancy-in-common relationship. A tenancy-in-common relationship is generally not fiduciary in nature, but where the cotenant comes into possession of funds belonging to another co-tenant he becomes a fiduciary and trustee of such, and must account to his fellow co-tenants. When one or more working interest owners agree to drill a well and appoint an operator to manage and control the activities in jointly developing the property, the relationship between the parties is that of joint adventurers unless modified by contract. A joint venture is essentially a partnership formed for a specific purpose and for a limited time, and is largely governed by the law of partnerships. In Oklahoma, there is no legal distinction between a joint adventure and a mining partnership, and the law of partnership applies.

In order to have a mining partnership between the developing parties, the Oklahoma Supreme Court has established three requisites which must be present: (1) a joint interest in the property; (2) an agreement to share in the profits or losses

333. Sturm v. Ulrich, 10 F.2d 9 (8th Cir. 1925).
334. Carter Oil Co. v. Crude Oil Co., 201 F.2d 547 (10th Cir. 1953); Ludley v. Pure Oil Co., 157 Okla. 1, 11 P.2d 102 (1932).
337. WILLIAMS & MYERS, supra note 336, at § 437; C.F. Wilcox Co. v. Empire Oil Co., 195 F.2d 860 (5th Cir. 1952).
of the venture; and (3) actions or conduct showing cooperation in the project.\textsuperscript{338} Joint ownership by itself will not create a mining partnership.\textsuperscript{339} Nevertheless, the parties must have some type of joint interest in the property or a mining partnership cannot exist. In \textit{Gilroy v. White Eagle Oil Co.},\textsuperscript{340} parties who received assignments of leasehold interest claimed they were part of a mining partnership, and that another partner had a duty to pay the delay rentals on the jointly owned leases. Because the leases had expired prior to their assignment there could be no joint ownership, and the court held there was no mining partnership.\textsuperscript{341}

While the first two elements are commonly present in the development and drilling of an oil and gas well, the actions or contacts needed to show "cooperation" are not easily defined and have created many problems for the courts.\textsuperscript{342} Each case involving cooperation and a mining partnership must be determined by its own facts.\textsuperscript{343} Oklahoma courts have said that the mere joint ownership of a lease does not constitute cooperation.\textsuperscript{344} Where investors visited and examined the leasehold, however, the court has held that this element had been satisfied.\textsuperscript{345} The court in \textit{Oklahoma Co. v. O'Neil} stated that it was significant that the parties who visited the drillsite did not have the knowledge or skills that would have allowed them to offer more cooperation in the development and operation of the leases.\textsuperscript{346} "Cooperation" has been defined by the Oklahoma Supreme Court as the ability to "act or operate jointly with another or others."\textsuperscript{347} Where a party furnished funds and materials for drilling, took numerous trips to the


\textsuperscript{339} Jenkins, 383 P.2d at 647.

\textsuperscript{340} 201 F.2d 113 (10th Cir. 1952).

\textsuperscript{341} Id. at 116.

\textsuperscript{342} Williams & Meyers, supra note 336, at § 435.

\textsuperscript{343} Edwards, 350 P.2d at 501.


\textsuperscript{345} O'Neil, 440 P.2d at 985.

\textsuperscript{346} Id.

\textsuperscript{347} Jenkins, 383 P.2d at 647 (quoting WEBSTER'S NEW INTERNATIONAL DICTIONARY).
field to examine the property, and tended to the financial details, a mining partnership was held to exist due to the "cooperation" between the parties.\(^{348}\)

The mere interest in the success of a well will not automatically create a mining partnership. In *Jenkins v. Pappas*,\(^{349}\) a party assigned the lease being developed. The assignor retained an overriding royalty interest, agreed to pay $2 per foot for any dry holes drilled, and posted a bond to insure that the drilling activities would comply with the Osage Agency rules and regulations. The court held that there was not a mining partnership between the parties, reasoning that a "farm-out" situation existed under the facts of the case.\(^{350}\) Under a farmout the assignor merely transfers the risk of developing the leasehold interest to another.

The courts have stated that:

> Where a mining partnership exists, each partner is liable to the others for his share (depending upon his interest) of the expenses and losses incurred in the enterprise and there is a lien for such upon his interest in the property or proceeds therefrom in favor of creditors or of other partners who have made advances."\(^{351}\)

A mining partner would thus have a lien against his co-partner's interest in a well for his share of the developmental cost.

A mining partnership, while similar to a partnership in many respects, also varies from a regular partnership in several important ways. First, like a regular partnership, each partner has a fiduciary duty to his co-partners.\(^{352}\) A mining partnership, like a regular partnership, can be formed by express agreement or by implication.\(^{353}\)

Unlike a regular partnership, the mining partnership is not dissolved when the interest of a mining partner is transferred to another party.\(^{354}\) The party acquiring the interest

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\(^{348}\) Dana v. Searight, 47 F.2d 38, 41 (10th Cir. 1931).
\(^{349}\) 383 P.2d at 645.
\(^{350}\) 337 P.2d at 647-48.
\(^{351}\) Dana, 47 F.2d at 41-42 (quoting Sturm v. Ulrich, 10 F.2d 9, 12 (8th Cir. 1925)).
\(^{352}\) *Williams & Meyers, supra* note 336, § 435.
\(^{353}\) *Id.* at § 435.1.
\(^{354}\) Sturm, 10 F.2d at 12.
from a mining partner is automatically in a partnership with the existing mining partners. Thus unlike a regular partnership, death or bankruptcy does not terminate a mining partnership.

Many jurisdictions provide that a corporation cannot be a mining partner. Under Oklahoma law, the courts have not adopted this view and have held that there is nothing to prevent a corporation from becoming a mining partner. In jurisdictions where corporations cannot be mining partners, the courts have generally found that they were joint venturers, and therefore liable under the same principles of partnership law.

In a recent Texas case, the issue of whether a mining partnership relationship could exist under a A.A.P.L. Model Form Operating Agreement was addressed. In this case an operator of a well attempted to collect drilling costs from two non-operating owners. The non-operators claimed that the operating agreement created a mining partnership or joint venture relationship, and that the operator had breached its fiduciary duties inherent to such a relationship.

The court stated that:

joint owners of an oil and gas lease may contract for the operation of leases by one of them and for the operator, in the event of success, to pay the other joint owners one-half of the proceeds of the sale of the oil and gas less the expenses of finding it, without creating ajoint venture or a mining partnership.

The Texas court noted that the non-operating parties were excluded by the operating agreement from participation in the drilling, operating and control of the well, and limited their participation in the well by paying part of the cost of the

356. Kennedy, 105 Okla. at 4, 231 P. at 511.
357. WILLIAMS & MEYERS, supra note 336 at § 435.1.
358. Sturm, 10 F.2d at 13.
359. WILLIAMS & MEYERS, supra note 336, § 435.1.
361. 648 S.W.2d at 320. The Hamilton court also cited Luling Oil & Gas Co. v. Humble Oil & Refining Co., 144 Tex. 475, 191 S.W.2d 716 (1945), where the parties entered into a contract to drill a well which negotiated a joint venture or mining partnership.
well and visiting the well site. The court also stated that the operator retained control and managed the activities on the leasehold, and that the parties were severally and not jointly liable under the operating agreement. As such, the operator and non-operators were not in a joint venture or mining partnership under the standard form A.A.P.L. Model Form Operating Agreement and fiduciary principles were not applicable.  

As against third parties, each mining partner is liable for all work, material and expenses incurred in the development of the well. Therefore, while a mining partnership may be desirable in order to assert a miner's lien against a partner, it may not be desirable in regard to liability to third parties. An operating agreement expressly states it is not the intention of the parties to create a mining partnership, and many courts have stated the relationship of the parties is predicated on the terms of the operating agreement.

IX. EQUIitable RIGHTS AND LIENS

"An equitable lien is a right not recognized by law, based upon the equitable doctrine of unjust enrichment, to have a fund or specific property applied to the payment of...[a]n obligation." An equitable lien can arise by express contract showing an intent to charge a specific property with a lien, or can be implied from the relationship and dealings of the parties. Equitable liens are recognized by the Oklahoma courts.

In determining whether an equitable lien has arisen, the
facts and circumstances surrounding a particular case are of prime importance. In general, equitable liens will not be enforced against subsequent purchasers of the subject property who took in good faith, for value, and without constructive or actual notice.\textsuperscript{368} The Oklahoma courts have discussed the creation of an equitable lien:

[T]o dedicate property, or to agree to do so, to a particular purpose or debt, is regarded in equity as creating an equitable lien therein in favor of him for whom such dedication is made.\textsuperscript{369}

Equitable liens do not depend on possession, and can be created against property not yet in being or to be acquired in the future.\textsuperscript{370}

In general, the courts have held that a contract to pay a debt or obligation out of the proceeds of mineral production does not by itself create an equitable lien on the proceeds of mineral production.\textsuperscript{371} In Bullen v. De Brettville,\textsuperscript{372} an investor advanced $2,500 toward the drilling of a well in return for a contract entitling him to receive $5,000 from the first 15% of production from said well. The court, in applying California law held that the parties lacked intent to create a security interest in the proceeds of the well, and the fact that the contract had been breached did not impress an equitable lien on the production or the proceeds from the well drilled with the investor's funds. According to the court, the property owner must make the property clearly answerable for a debt before an equitable lien can be asserted.\textsuperscript{373}

In Oklahoma, the courts have departed from the general rule that the promise to pay an obligation out of the proceeds of a mine or well does not create an equitable lien against the property. In Davis v. Lewis,\textsuperscript{374} a party assigned its interest in

\textsuperscript{368} 5 American Law of Mining § 29.1 (Supp. 1982).
\textsuperscript{369} Mangless, 387 F. Supp. at 746 (quoting Mullens v. Geo. C. Wright Lumber Co., 182 Okla. 355, 77 P.2d 700 (1938)).
\textsuperscript{370} Clark v. Armstrong & Murphy, 180 Okla. 514, 72 P.2d 362 (1937).
\textsuperscript{371} 5 American Law of Mining § 29.2 (Supp. 1982); Bullen v. De Brettville, 239 F.2d 824 (9th Cir. 1956), cert. denied, 353 U.S. 947 (1947).
\textsuperscript{372} 239 F.2d 824 (9th Cir. 1956) cert. denied, 353 U.S. 947 (1947).
\textsuperscript{373} Id. at 841; see Guaranty Laundry Co. v. Lewis, 184 Okla. 613, 88 P.2d 893 (1939).
\textsuperscript{374} 187 Okla. 91, 100 P.2d 994 (1940).
an oil and gas lease for $1, with an additional $25,000 to be paid from a 7/6 share of the working interest in the lease. The assignment of the lease and the terms were recorded giving third parties the requisite notice. The court held that the interest in the $25,000 created an equitable lien in the proceeds from the production of the well drilled on the leasehold.

In *Mullens v. George C. Wright Lumber Co.*, a contract was recorded which gave a leasehold owner the option of purchasing a rig, required the owner to keep the rig free and clear of all liens and encumbrances, and required the owner to post a $1,000 bond to insure that laborers' and materialmen's liens were paid and discharged. By a subsequent unrecorded agreement, this fund created to discharge materialmen's liens was depleted. A party supplied parts to the rig, and claimed the recorded contract created an equitable lien in his favor. The Oklahoma Supreme Court agreed, and held that there was an equitable lien in favor of the supplier.

In *Phillips Petroleum Co. v. Gable*, Phillips entered into a contract to sell casing to a party owning a thirty percent working interest in a well. In return, Phillips was to be paid one-half of the proceeds attributable to the party's interest. The contract was recorded, giving constructive notice to third parties of Phillips' claim to the proceeds. The Tenth Circuit Court of Appeals held that Phillips had an equitable lien on one-half of the proceeds from the oil and gas well attributable to the 30% working interest.

In summary, the Oklahoma courts have recognized equitable liens where "[a] contract under which one party is to receive compensation for services out of a particular fund, if and when realized, and which has been performed by such party, gives him an equitable lien on the fund when created in the hands of anyone having notice of the contract." 378

In addition to the concept of equitable liens, an equitable mortgage may be created if the parties execute some other form of agreement but in fact intend it to operate as a mort-

375. 182 Okla. 355, 77 P.2d 700 (1938).
376. 182 Okla. at 357, 77 P.2d at 702-3.
377. 128 F.2d 943 (10th Cir. 1942).
gage. An equitable mortgage is treated for priority purposes as a legal mortgage or security interest which is generally subordinated to other creditors if not recorded or filed. If an equitable mortgage is recorded or filed, priority generally depends on the first-in-time rule.\textsuperscript{379} Contracts for deed and real estate purchase contracts have been held to create constructive or equitable mortgages.\textsuperscript{380} For example, a quit claim deed was held to be a mortgage in \textit{Republic Financial Corp. v. Mize}.\textsuperscript{381} An equitable mortgage can be created and enforced against property previously subject to a loan commitment.\textsuperscript{382}

In some circumstances a creditor may have an equitable claim based on the concept of subrogation. Typically this type of claim arises when a surety has paid workers and materialmen to complete a construction project pursuant to the requirements of a completion bond issued by the surety. Since the lien rights of the workers and materialmen would be superior to the rights of most other claimants, and since the surety is subrogated to those lien rights, the surety will generally have priority over most other claimants as well.\textsuperscript{383} One possible exception is the construction mortgagee which has recorded its mortgage prior to commencement of any work on the project. If properly documented this mortgage has priority over mechanics' and materialmen's liens, and hence any surety subrogated to the rights of those mechanics' and materialmen's liens.\textsuperscript{384} In any case the surety's claim is based on equitable rights of subrogation and is exempt from any of the

\textsuperscript{379} Examples could include a deed intended as security, a personal property lease used as a security agreement, or a conditional sales contract where the seller retains title until full payment by the purchaser. \textit{See e.g., Okla. Stat. tit. 12A, §§ 1-201(37), 9-102(1)(a), 9-202 (1981 & Supp. 1984); Okla. Stat. tit. 46, § 11 (1981); see also Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964) (en banc).}


\textsuperscript{381} 682 P.2d 207 (Okla. 1983).

\textsuperscript{382} \textit{Waukomis State Bank v. Fuksa}, \textit{(In re Fuksa)}, 23 Bankr. 258, 261 (Bankr. W.D. Okla. 1982).

\textsuperscript{383} \textit{See National Shawmut Bank v. New Amsterdam Cas. Co.}, 411 F.2d 843 (1st Cir. 1969); \textit{Mid-Continent Cas. Co. v. First Nat'l Bank & Trust Co.}, 531 P.2d 1370 (Okla. 1975).

filing or recordation requirements for legal liens. 385

X. THE OIL AND GAS JOINT OPERATING AGREEMENT AS CREATING A TRUSTEE TYPE RELATIONSHIP

An operating agreement establishes the relationship and duties of the operator and the non-operating parties with regard to the development of the oil and gas leasehold. A number of recent bankruptcy cases have discussed the nature of the relationships formed under the standard form operating agreement.

In Reserve Oil, Inc. v. Dixon,386 the court reviewed a situation where an operator sold a non-operator's share of the proceeds from a well, and used such proceeds from the well to pay expenses instead of distributing those proceeds to the proper parties as required under the operating agreement. The parties had signed a standard form 1977 A.A.P.L. Model Form Operating Agreement, which vested ownership in the oil and gas produced from the wells in the non-operating parties to the extent they owned interest in the well. The operating agreement provided that the non-operators would dispose of their share of the production, or if the non-operator did not sell its share of production the operator could sell that portion of production. The operating agreement also set out the payment of costs and expenses in detail, and granted a lien to the operator for unpaid costs.

The Reserve court stated that the operating agreement did not simply create a contractual indebtedness to the non-operator on the part of the operator. Because the operator has full control of the activities on the leasehold property and of the proceeds, the court held that the operator was in a "trustee type relationship" with the non-operator under the operating agreement. The court noted that it did not imply that there was a general agency relationship between the operator and non-operator as to third parties.387

A recent bankruptcy decision has affirmed the trustee

385. See National Shawmut Bank, 411 F.2d at 849.
386. 711 F.2d 951 (10th Cir. 1983).
387. Id. at 953; see In re Mahan & Rowsey, 27 Bankr. 883, 886 (Bankr. W.D. Okla. 1983). The court also held that a standard form operating agreement did not create an agency relationship between the operator and non-operators.
type relationship under a joint operating agreement. In Turley v. Mahan & Rowsey (In re Mahan & Rowsey) Mahan & Rowsey was the operator of a well in which Turley participated as a working interest owner, and both parties had signed a joint operating agreement. Mahan & Rowsey billed Turley for his proportionate share of the costs. Relying on the erroneous bills, Turley overpaid his share of the drilling expenses. The court affirmed Mahan & Rowsey’s trustee type relationship with Turley, and recognized Turley was entitled to recover a certain portion of the overcharges.

The Turley decision, however, only allowed Turley to recover the amount of overpayment which could be traced into the hands of the receiver. In order to establish a trust relationship that excludes property from the bankruptcy estate and recover that property, a claimant must: (1) establish and prove the existence of a trust; and (2) trace the identity of his property. Bankruptcy courts, in the exercise of their equitable powers, may abandon the strict tracing requirement in exceptional circumstances. The court will only allow an exception where it will result in equitable treatment of competing elements. In most situations, the general rule requires the claimant to trace his property.

XI. OTHER CLAIMS

Buyers of personal property in the ordinary course of business are protected by section 9-307(1) of the Uniform Commercial Code from security interests created by the seller. Protected parties may include a merchant; for example, in Oklahoma a grain elevator purchasing a farmer’s crop will take free and clear of the farmer’s crop loan, subject to certain affidavit requirements. This provision does not protect a buyer of livestock from a rancher, and the definition of

389. Rosenberg v. Collins, 624 F.2d 659, 663 (5th Cir. 1980).
391. 649 F.2d at 1240-41.
393. OKLA. STAT. tit. 12A, § 9-307(3) (Supp. 1984-85). This is a non-uniform Oklahoma amendment.
"buyer" does not include a creditor taking a security interest.\textsuperscript{394} Aside from crop security interests, the main effect is to cut off inventory security interests upon retail sale.

	extit{Lis pendens} is a notice that a claim is being asserted against property in a lawsuit. Third parties are subject to this lien after the date the petition is filed, if the statutory requirements are met.\textsuperscript{395} \textit{Lis pendens} is not itself a lien, and therefore does not confer the status of a secured creditor if the debtor files bankruptcy before judgment.

One other state law priority issue deserves mention. In \textit{Utica National Bank and Trust v. Associated Producers},\textsuperscript{396} the Oklahoma Supreme Court awarded priority over a perfected security interest to a coal broker on essentially an agency theory by incorporating the law of setoff. Although this is an unusual case, probably limited to its facts, it raises the spectre of further modification of the usual priority rules by means of creative adaptation of traditional rules of agency and setoff.\textsuperscript{397}

\section*{XII. Summary of Bankruptcy Liens and Powers}

The trustee in bankruptcy, or a debtor in possession, obtains a lien on the debtor’s entire estate as of commencement of the case.\textsuperscript{398} Priority against secured creditors generally depends on the first-in-time rule.\textsuperscript{399} The trustee also has the power to avoid fraudulent transfers under the Bankruptcy Code and the Uniform Fraudulent Conveyance Act.\textsuperscript{400} The trustee can also avoid certain statutory liens.\textsuperscript{401} This is subject

\begin{itemize}
\item \textsuperscript{394} \textit{Id.} at \S 1-201(9).
\item \textsuperscript{395} \textit{Id.} at tit. 12, \S 2004 (P) (Supp. 1984); see continuing legal education materials, \textquotedblleft Oklahoma Debtor/Creditor Law	extquotedblright (OCU/CLE March 2, 1985).
\item \textsuperscript{396} 622 P.2d 1061 (Okla. 1981).
\item \textsuperscript{398} 11 U.S.C.A. \S\S 544(a), 1107(a) (West Supp. 1985).
\item \textsuperscript{401} 11 U.S.C.A. \S 546 (West Supp. 1985).
\end{itemize}
to the seller's right to reclaim under the Uniform Commercial Code, and to an owner's right to reclaim grain sold to a grain storage facility.

Preferential transfers are also avoidable under the Bankruptcy Code. The trustee may avoid, or set aside, any transfer from the debtor that is: (1) to or for the benefit of the creditor; (2) for or on account of an antecedent debt; (3) made while the debtor was insolvent (there is a presumption of insolvency during the ninety day period preceding bankruptcy); (4) on or within ninety days prior to the filing of the bankruptcy petition (extended to one year for transfers to "insiders"); or (5) diminishing the estate available to other creditors or permitted the recipient to improve his or her position in bankruptcy. Specifically protected from avoidance under the preference rules are transfers that are: (1) part of a contemporaneous exchange of value; or (2) made in the ordinary course of business; or (3) part of a purchase money secured transaction perfected within ten days of the date the debtor received possession of the collateral; or (4) the result of a "floating lien" (after-acquired property security interest) that does not improve the creditor's position during the ninety day or one year preference period; or (5) the result of a statutory lien not avoidable under section 545 of the Bankruptcy Code; or (6) primarily consumer transactions aggregating less than $600.

404. Id. at § 547 (1978 & West Supp. 1985).
405. Id. at § 547(b) (West Supp. 1985).
406. Id. at § 547(c)(1). Contemporaneous means within ten days.
407. Id. at § 547(c)(2).
408. Id. at § 547(c)(3)(B).
409. Id. at § 547(c)(5).
410. Id. at § 547(c)(6).
411. Id. at § 547(c)(7).
XIII. SOME INITIAL BANKRUPTCY PROBLEM AREAS FOR CREDITORS

A. SELECTED DEFINITIONS

There are some important definitions which must be mastered in order to understand the Bankruptcy Code. For example, consider the “affiliate” and “insider” provisions. An “affiliate” is defined as an entity that owns, controls or has the power to vote 20% of the shares of a corporate debtor.412 “Insider” is defined to include affiliates and any relative of an individual debtor (related within the third degree of affinity or consanguinity) or director of a corporate debtor or partner of a general partnership.413

Any transfer by the debtor to an affiliate or other insider within one year prior to bankruptcy, if not made for full and contemporaneous consideration, may be subject to the preference rules. If found to be preferential, the transfer may be set aside by the trustee and the property recovered from the recipient for the benefit of the bankruptcy estate.414 Transfers are normally subject to the preference rules only if made within the ninety days prior to bankruptcy, but for affiliates and other insiders this period is extended to one year. Examples of preferential transfers might include repayment of the debt owed an insider, or perfection of a security interest if the effect was to convert an insider’s antecedent unsecured debt into a secured claim.415

Creditors should weigh the dangers of insider status against the perceived benefits of representation on the debtor’s board of directors. Creditors should also be wary of attempting to influence the direction of the debtor’s business through granting credit or credit withholding decisions, since insider status can be awarded on the basis of actual control of the debtor’s affairs regardless of any formal title or officeholding.416 An insider who abuses such “control” of the debtor may also be subject to having its claim subordinated to the

412. Id. at § 101(2) (West Supp. 1985).
413. Id. at §§ 101(28), (37) (West Supp. 1985).
415. See, e.g., Glessner v. Massey-Ferguson, Inc., 353 F.2d 986 (9th Cir. 1965).
claims of all other creditors under section 510 of the Bankruptcy Code.

Other important bankruptcy definitions include "farmer," "lien," and "security." "Farmer" is defined as a person receiving more than 80% of his gross income from a farming operation.\(^{417}\) Farmers are granted protection from involuntary bankruptcy under section 303 of the Bankruptcy Code, but a farmer whose farming income dips below 80%, for instance due to crop failure or perhaps an oil lease bonus, would lose this protection. "Lien" means any charge against property, including a security interest or mortgage.\(^{418}\) "Judicial lien" means a judgment lien or lien by levy.\(^{419}\) These definitions may not be in accord with other commonly accepted uses of the terms defined.

"Security" under the Bankruptcy Code includes notes, stocks, bonds, collateral trust certificates, certificates of deposit, participation interests in mineral royalties and leases, and limited partnership interests. It does not include checks, drafts or letters of credit.\(^{420}\) It should be noted that section 8-102 of the Uniform Commercial Code differentiates between certificated and uncertificated securities, and section 3-104, treats notes and certificates of deposit as instruments rather than securities. Despite the latter provision, the court in Victory National Bank of Nowata v. Oklahoma State Bank, Vinita\(^{421}\) found that the pledgee of a certificate of deposit was a purchaser of a security protected by article 8 of the Code. For purposes of article 9 of the Code, section 9-105(1) includes certificated (but not uncertificated) securities within the definition of instrument, along with "any other writing which evidences a right to the payment of money . . . and is . . . transferred by delivery with any necessary endorsement or assignment." Section 9-304 then limits the article 9 perfection rules to uncertificated securities, a deferral to the security

\(^{417}\) Id. at §§ 101(17), (18) (1978).
\(^{418}\) Id. at § 101(31) (West Supp. 1985).
\(^{421}\) 520 P.2d 675 (Okla. 1973).
perfection provisions of sections 8-313 and 8-321 of the Code. To further cloud the distinction, the United States Supreme Court recently held that commercial paper is within the definition of "securities" for purposes of the Glass-Steagall Act, prohibiting banks from underwriting and marketing securities.\textsuperscript{422} The term security is a chameleon of definitions.

One of the most famous, or perhaps infamous, changes included in the Bankruptcy Reform Act of 1978 was the somewhat novel approach to due process incorporated in section 102(1) of the Bankruptcy Code. Under the Bankruptcy Code, most actions that could result in deprivation of property are subject to a requirement of prior "notice and a hearing." That requirement is defined at section 102(1)(A) as "such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances." Furthermore no hearing need be provided if there is insufficient time before the proposed act "must be done," or if notice is given and no hearing is requested. The court is therefore authorized to provide minimal notice, "as appropriate," and no hearing. A party whose interest is being affected should be prepared to respond without notice and to request a hearing where desired, notwithstanding an apparent requirement that prior notice and a hearing be provided.

A "debtor in possession" during a Chapter 11 reorganization has essentially the same rights and powers as a trustee.\textsuperscript{423} This means that a debtor may be able to attack in bankruptcy the same transaction that he voluntarily agreed to before the bankruptcy.\textsuperscript{424} It can be particularly galling for a creditor to see the debtor's bankruptcy estate enriched as a result of the debtor's ability to impeach his own agreement.\textsuperscript{425}

\begin{footnotes}
\end{footnotes}
B. The Automatic Stay

The automatic stay frequently confounds creditors. The filing of a bankruptcy petition automatically operates as a stay prohibiting the commencement, continuation or enforcement of any action or proceeding concerning any debt, security interest, judgment or claim against the debtor. As amended in 1984, the Bankruptcy Code additionally prohibits any act to obtain, encumber or exercise control over property of the debtor. There are exceptions in section 362(b) of the Bankruptcy Code for criminal proceedings, collection of alimony, maintenance and child support and perfection of certain security interests under sections 546(b) and 547(e)(2)(A). The latter are designed to protect the rights of creditors to perfect security interests within the ten day periods specified in sections 9-312(4) and 9-313(4)(a) of the Uniform Commercial Code, therefore qualifying for protection under sections 546(b), 547(c)(1) and possibly (3), and 547(e)(2)(A) of the Bankruptcy Code, despite an intervening bankruptcy filing. In addition, sections 546(c) and (d) of the Bankruptcy Code recognize the rights of a reclaiming seller of goods, grain or fish to exercise those rights notwithstanding bankruptcy, subject to certain limitations.

Violation of the automatic stay, even if inadvertent, may result in subordination of the creditor’s claim to a level below all other claims, thereby effectively precluding any recovery. Furthermore, a 1984 revision requires the court to award actual damages, plus attorney’s fees and court costs, to any individual injured by a willful violation of the stay. Punitive damages are permitted in “appropriate circumstances.” Routine handling of a negotiable instrument, such as making presentment or giving notice of dishonor, is not barred by the stay.

427. Id. at § 362(A).
428. Id. at §§ 362(a)(3),(4),(5).
429. Id at § 510.
430. Id. at § 363(n).
431. Id. at § 362(b)(11) (West Supp. 1985).
C. Relief from the Stay and the Concept of "Adequate Protection"

Section 362(c) of the Bankruptcy Code provides that the automatic stay remains effective as long as the collateral remains property of the estate, for example, until the case is closed or dismissed.\(^{432}\) If certain requirements are met, however, a creditor may obtain relief from the stay. Relief from the stay may include termination, annulment, modification or conditioning of the stay.\(^{433}\) The bases for such relief are: (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or (2) with respect to a stay of an act against property, if — (A) the debtor does not have an equity in such property, and (B) such property is not necessary to an effective reorganization.\(^{434}\) A companion provision is section 554, providing for the estate to abandon property that is of "inconsequential value" and benefit to the estate. This can be done upon motion of a party in interest (after notice and a hearing as defined in section 102(1)). Property not otherwise administered is deemed abandoned upon closing of the case.\(^{435}\) From the statutory language one can surmise that a property which falls within category (2) above\(^ {436}\) will be of little use to the estate and probably the secured creditor will have comparatively little difficulty obtaining relief from the stay. Of course the requirements under category (2) must be demonstrated, and this raises the possibility of valuation problems, as well as the need to determine what is or is not necessary to an effective reorganization.

Still, the greater source of potential for dispute seems to be category (1) above,\(^ {437}\) which incorporates as the only example of "cause" the concept of "adequate protection." Ade-

\(^{432}\) Id. at § 541 (West Supp. 1985); see Winfrey Structural Concrete Co. v. I.R.S., 5 Bankr. 389 (Bankr. D. Colo. 1980) (for what constitutes property of the estate).
\(^{434}\) Id.
\(^{435}\) Id. at § 554(b), (c) (1978); On valuation of collateral and the concept of "inconsequential value" see, e.g., Catholic Credit Union v. Siegler, (In re Siegler), 5 Bankr. 12 (Bankr. D. Minn. 1980); In re Adams, 2 Bankr. 313 (Bankr. M.D. Fla. 1980); In re Brannon, 5 Bankr. 505 (Bankr. D.V.I. 1980).
\(^{437}\) Id. at § 362(d)(1).
quate protection in turn is illustrated, but not defined by three examples in section 361 of the Bankruptcy Code:

(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, 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; (3) granting such other relief, other than entitling 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.\textsuperscript{439}

The phrase "indubitable equivalent" as used in subsection (3) originated with Judge Learned Hand's opinion in Metropolitan Life Insurance Co. v. Murel Holding Corp.\textsuperscript{440} In that case Judge Hand suggested four ways that a court can provide adequate protection to a secured creditor in bankruptcy: (1) keep the lien in "statu quo" by confining the proceeding to the debtor's equity; (2) sell the collateral free and clear but attach the lien to the proceeds; (3) appraise and pay the value of the lien; or (4) provide the creditor the value of "a substitute of the most indubitable equivalence."\textsuperscript{441} Although nowhere defined, Judge Hand's idea was incorporated into subsequent revisions of the Bankruptcy Act and has been handed down through succeeding generations to be included in the current Bankruptcy Code at section 361(3).

The result of this scheme is that a secured creditor may be stayed from enforcing its security interest while the debtor proceeds with use of the collateral.\textsuperscript{442} If the creditor seeks relief from the stay under section 362(d), the court may provide as an alternative some form of adequate protection,

\textsuperscript{438} Id. at § 361.
\textsuperscript{439} 75 F.2d 941 (2d Cir. 1935).
\textsuperscript{440} Id. at 942.
\textsuperscript{442} Id. at § 363.
illustrated at section 361(3) by the concept of indubitable equivalence. Typically, this could be accomplished by requiring the debtor to make periodic cash payments at least equal to the depreciation in the value of the collateral below the amount of the creditor's claim, plus interest to compensate for the time value of money lost by the creditor as a result of the delay in enforcement of the security interest. Of course if the value of the collateral exceeds the amount of the creditor's claim, the initial depreciation can be viewed as diminution of the debtor's equity without any infringement of the creditor's secured claim. The creditor would still be entitled to interest as compensation for the delay in enforcement of the security interest.

D. Use of Collateral During Bankruptcy

Creditors are also concerned with the use of cash and non-cash collateral. Section 363 of the Bankruptcy Code distinguishes between two types of collateral — cash collateral and non-cash collateral. The distinction is important as the two types are treated quite differently. "Cash collateral" is defined at section 363(a) as "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired . . . and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest . . . whether existing before or after the commencement of a case." The definition is broad and might be more accurately described as covering liquid assets of the debtor estate. Non-cash collateral is any other collateral.

Section 363(c) permits the trustee to use, sell or lease any property of the estate (including non-cash collateral) in the ordinary course of the debtor's business, without notice or a hearing. This of course is appropriate only if the debtor has a business and the trustee is authorized to operate it under sections 721, 1108, or 1304 of the Bankruptcy Code. In other

443. See e.g., General Motors Acceptance Co. v. Lum, (In re Lum), 1 Bankr. 186 (Bankr. E.D. Tenn. 1979).
445. Id. at § 363(b)(1).
446. Id. at § 363(a).
cases the trustee can use, sell, or lease property of the estate, including noncash collateral, outside the ordinary course of business, but only after "notice and a hearing" as defined at section 102(a).\textsuperscript{447}

The rule for "cash collateral" is slightly different. The trustee cannot use, sell, or lease cash collateral unless: (a) each entity that has an interest in such cash collateral consents; or (b) the court, after notice and a hearing, authorizes such use, sale or lease in accordance with provisions of this section.\textsuperscript{448} Cash collateral can therefore be utilized by the trustee only with consent or "notice and a hearing." and in the latter case only where the court so authorizes. In contrast, noncash collateral can be used without notice or a hearing in the ordinary course of the debtor's business; and in other cases after "notice and a hearing" without further need for court authorization. This rule is subject to a requirement that the court provide "adequate protection" to any secured creditor who objects, under section 363(e):

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest.\textsuperscript{449}

In addition the trustee can sell property of the estate being claimed by a secured creditor only if: (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.\textsuperscript{450}

In summary, the trustee can sell, use or lease collateral subject to a requirement that adequate protection be provided

\textsuperscript{447} Id. at § 363(c)(2). Section 363(c)(4) requires the trustee to segregate and account for all cash collateral.

\textsuperscript{448} Id. at § 363(f).

\textsuperscript{449} Id. at § 363(e).

\textsuperscript{450} Id. at § 363(f).
to any objecting secured party. The trustee's right to sell that collateral free and clear of the creditor's security interest is also subject to the section 363 requirements listed above. Other provisions permit the trustee to sell not only the interest of the debtor but that of any co-owner of the property, subject to certain exceptions,451 and provide that the trustee has the burden of proof on the issue of adequate protection.452 The secured creditor has the burden of proving the validity, priority and extent of its security interest.453

E. Real Estate Leases

The automatic stay does not preclude eviction by the lessor of a tenant whose lease of non-residential real property has expired.454 For executory leases and residential leases the Bankruptcy Code455 provides a slightly different rule. The starting point is the basic rule in section 365(a) that the trustee can assume or reject any executory contract or unexpired lease of the debtor. The trustee generally must make this election within sixty days for Chapter 7 (liquidation) cases or prior to confirmation of the plan for Chapter 11 (reorganization) and Chapter 13 (wage earner) cases.456

If the trustee elects to assume the lease or contract he or she must also provide adequate assurance that any default will be cured and that future performance will conform to the terms of the lease or contract.457 The trustee may also be required to furnish any deposit or security that would be required under the lease for any similar tenant.458 The trustee's right to assume the lease is not affected by any ipso facto clause in the lease purporting to allow the lessor to terminate the lease upon the lessee's insolvency.459 Such clauses are ren-

451. Id. at § 363(h).
452. Id. at § 363(o).
453. Id.
454. Id. at § 362(b)(10). A companion provision at 11 U.S.C.A. § 365(c)(3) (West Supp. 1985) prohibits the trustee from assuming and enforcing any nonresidential real estate lease that terminated prior to bankruptcy.
455. Id. at § 365.
456. Id. at § 365(d).
457. Id. at § 365(b).
458. Id. at § 365(l).
459. Id. at § 365(e).
dered unenforceable in bankruptcy. Similarly, the trustee's right to assign the leasehold interest is protected, despite any ipso facto clause to the contrary. If such an assignment is made, there is a novation and the lessor gives up all recourse against the debtor and the bankruptcy estate in return for enforceability of the lease against the assignee. If the trustee elects to reject the lease (or fails to take action within the time limits specified in section 365(d)), the estate may be liable for liquidated damages as provided in the lease. The amount of this claim, however, will be limited by section 502(b)(6) of the Bankruptcy Code.

XIV. PRIORITIES IN BANKRUPTCY

The sources of priority resolution include the following provisions: section 364 (credit obtained by the trustee), section 503 (administrative expense), section 507 (the general priority provision), section 724 (priority of certain liens in a liquidation), and section 726 (distribution to general creditors and the debtor). In addition, a secured claim must be considered to have a first priority claim against the collateral, despite the limits on enforceability of the security interest under sections 362, 363 and 364. A schematic of these priorities could be set forth as follows:

<table>
<thead>
<tr>
<th>Priority Number</th>
<th>Description Of Claim</th>
<th>Bankruptcy Code Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>Debt incurred by trustee given lien superior to prior liens on property</td>
<td>Section 364 (d)</td>
</tr>
<tr>
<td>Second</td>
<td>Unavoidable liens in order of state law priority.</td>
<td>Sections 502, 506, 724</td>
</tr>
</tbody>
</table>

460. Id. at § 365(f).
461. Id. at § 365(k).
462. Id. at §§ 364, 503, 507, 724, 726.
463. Id. at §§ 362, 363, 364.
<table>
<thead>
<tr>
<th>1985]</th>
<th><em>Lien Rights and Bankruptcy</em></th>
<th>533</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third (or Fourth)</td>
<td>Super administrative priority as a means of granting “adequate protection” to a secured creditor</td>
<td>Section 507 (b)</td>
</tr>
<tr>
<td>Fourth (or Third)</td>
<td>Super administrative priority to enable the trustee to borrow for operational expenses</td>
<td>Section 364 (c)</td>
</tr>
<tr>
<td>Fifth</td>
<td>Administrative claims</td>
<td>Sections 503 and 507(a)(1)</td>
</tr>
<tr>
<td>Sixth</td>
<td>Unsecured claims for debt extended in an involuntary case after the petition is filed but before the trustee is appointed</td>
<td>Sections 502 (f) and 507 (a)(2)</td>
</tr>
<tr>
<td>Seventh</td>
<td>Unsecured claims for wages, salaries, commissions, including vacation, severance and sick pay, up to $2,000 per individual</td>
<td>Section 507 (a)(3)</td>
</tr>
<tr>
<td>Eighth</td>
<td>Unsecured claims for contributions to an employee benefit plan, up to $2,000 per individual</td>
<td>Section 507 (a)(4)</td>
</tr>
<tr>
<td>Ninth</td>
<td>Unsecured claims of farmers against a bankrupt grain storage facility or the sales proceeds.</td>
<td>Section 507 (a)(5)</td>
</tr>
</tbody>
</table>

464. There is some uncertainty concerning the relative priority of §§ 364(c) and 507(b). Both provisions seem to provide priority over all other administrative claims.
<table>
<thead>
<tr>
<th>Tenth</th>
<th>Unsecured claims of individuals up to $900 each for deposits paid in connection with the sale or lease of consumer goods or services.</th>
<th>Section 507 (a) (6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eleventh</td>
<td>Unsecured claims to income or gross receipts taxes for the preceding three taxable years.</td>
<td>Section 507 (a)(7)</td>
</tr>
<tr>
<td>Twelfth</td>
<td>General creditors (unsecured claims)</td>
<td>Section 726</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Chapter 7-liquidation</td>
</tr>
<tr>
<td>Thirteenth</td>
<td>Claims subordinated by the court due to equitable considerations</td>
<td>Section 510 (c)</td>
</tr>
</tbody>
</table>

In addition, in a Chapter 7 liquidation proceeding, certain tax lien claims will be subject to the following priority scheme under section 724.\(^{465}\)

| First                         | Liens senior to the tax lien, and not avoidable                                                               | Section 724 (b)(1)  |
| Second                        | Administrative claims under sections 507 (a) 1-507 (a)(5), up to the amount of the tax lien                   | Section 724 (b)(2)  |
| Third                         | The tax lien, for any amount in excess of the administrative claims described immediately above                | Section 724 (b)(3)  |
| Fourth                        | Liens junior to the tax lien                                                                                  | Section 724 (b)(4)  |

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465. For a possible explanation for the seemingly odd priority provisions of section 724, see *In re Quaker City Uniform*, 238 F.2d 155 (3d Cir. 1956) and *California State Dep't of Employment v. United States*, 210 F.2d 242 (9th Cir. 1954). Regarding statutory liens, see also *Bankruptcy Code* section 545 regarding the trustee’s avoidance powers.
Fifth  The tax lien, to the extent not satisfied above  Section 724 (b)(5)

Sixth  To the bankruptcy estate  Section 724 (b)(6)

XV. SPECIAL PROBLEMS WITH CONSUMER BANKRUPTCIES — CHAPTER 13

A. Comparison With Other Chapters

There are some additional problems for creditors if the debtor files a petition for a Chapter 13 wage earner plan, so called because it is limited to individuals with regular income.\(^{466}\) Conceivably this could include the proprietor of a small business and hence is not technically limited to wage earners. A debtor cannot be put into Chapter 13 involuntarily.\(^{467}\)

In addition to the automatic stay at section 362 (applicable to all bankruptcies), there is a special stay for Chapter 13 cases. This provides for a stay of all actions to collect a consumer debt from any co-borrower, surety or guarantor of the debtor filing the bankruptcy petition.\(^{468}\) “Consumer debt” is defined in section 101(7) of the Bankruptcy Code as any debt “incurred by an individual primarily for a personal, family, or household purpose.”\(^{469}\) There is no counterpart to this stay elsewhere in the Bankruptcy Code. It prohibits any collection action, not only against the bankrupt debtor, but against any co-debtor, unless: (1) the co-debtor is a commercial surety or otherwise signed in the ordinary course of business, for example, a seller who co-signed in order to help the buyer finance the sale; or (2) the case is converted to Chapter 7 or 11. A creditor can obtain relief from the Chapter 13 stay, in order to proceed against co-debtors, upon request and a showing the co-debtor received consideration for the claim, or that the proposed plan does not include payment of the claim, or that

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467. Id. at § 303(b).
468. Id. at § 1301.
469. Id. at § 101(7).
continuation of the stay will irreparably harm the creditor. 470 Like the section 362 stay, this stay does not apply to present-
ment, dishonor and notice of dishonor instruments.

A debtor has the absolute right to convert his Chapter 13 case to a Chapter 7 liquidation case. This right cannot be waivered. 471 A creditor has the right to request such a conver-

sion but the court can do so only after notice and a hearing and only for cause. "Cause" includes unreasonable delay or failure to formulate or make payments under a plan. 472

B. The Chapter 13 Plan

The plan must meet the requirements of sections 1322 and 1325 of the Bankruptcy Code. The requirements include full payment of all claims entitled to priority under section 507, 473 allocation of a portion of the debtor's future earnings as necessary to effectuate the plan and equal treatment of all claims within a particular class. 474

However, the plan may discriminate in favor of a debt co-
signed by another individual. For example, the plan can pro-

vide full payment of a debt guaranteed by a friend or relative, in order to protect the co-borrower, while proposing a lesser payment for other debts. 475 In addition, the plan may modify the rights of secured creditors, except a mortgagee of the debtor's residence, and/or the rights of unsecured creditors. The plan may also provide for curing any previous default of the debtor, permitting the trustee to defeat an effort to accele-
rate payments otherwise permitted by section 1-208 of the Uniform Commercial Code. 476 This, coupled with the automatic stay, will interrupt and may ultimately require dismis-

sal of pending actions to foreclose mortgages and/or enforce security interests against the debtor.

In addition to the requirements for the plan under sec-

470. Id. at § 1301(c).
471. Id. at § 1307(a).
472. Id. at § 1307(c).
473. Id. at § 507.
474. Id. at § 1322(a).
475. Id. at § 1322(b)(1).
476. Id. at § 1322(b)(3); see Grubbs v. Houston First Am. Sav. Ass'n, 730 F.2d 236 (5th Cir. 1984); In re Clark, 738 F.2d 869 (7th Cir. 1984).
tion 1322, the plan can be confirmed only if it meets the additional requirements provided by section 1325 of the Bankruptcy Code. These provide that the plan must have been proposed in good faith and must provide for distribution to unsecured creditors of an amount not less than that which would be paid to each creditor in a Chapter 7 case. The court must conclude that the debtor will be able to make all payments as provided in the plan. In addition each secured claimant (1) must have accepted the plan; or (2) must have been allowed to retain its lien and receive the value of its secured claim; or (3) must have received surrender of its collateral.

In the past these requirements did not preclude confirmation of zero payment or very low payout plans. The 1984 revisions included a new provision that may have an impact in some low payment cases. A new requirement was added at section 1325(b), which provides that if there is an objection to the plan it can be confirmed only if it provides for full payment to the objecting creditor or for payment under the plan of the debtor's entire disposable income. "Disposable income" is defined in section 1325(b)(2) as that income not reasonably necessary for the maintenance or support of the debtor or his dependent or survival of his business.

C. Payment Under the Plan

A 1972 revision to section 1326(a)(1) of the Bankruptcy Code requires that the debtor commence making the payments stipulated in the plan within thirty days after the plan

479. Id. at § 1325(a)(5) (West Supp. 1985). On the meaning of "value" in this context, General Motors Acceptance Co. v. Lum, (Bankr. E.D. Tenn. 1979). On the meaning of "value" in this context, see (In re Lum), 1 Bankr. 186.
is filed. A companion revision to section 1302(b)(5) imposes an affirmative duty on the Chapter 13 trustee to "ensure that the debtor commences making timely payments under section 1326." A 1984 revision adding section 109(f) prohibits filing a bankruptcy petition within 180 days of the dismissal of a prior petition. The purpose of these revisions was to discourage the use of bankruptcy as a purely delaying tactic, and to put some teeth into the provisions requiring debtor performance.

D. Discharge in Consumer Cases

The Chapter 13 discharge provisions at section 1328(a) are considerably broader than the Chapter 7 liquidation discharge provisions at section 523(a). Section 523(a) lists nine categories of debts that are not dischargeable in a Chapter 7 case. Of these only one type of obligation, described at section 523(a)(5) (alimony, child support and maintenance) is non-dischargeable in Chapter 13. In other words, a wide variety of debts that are non-dischargeable in a Chapter 7 case can be discharged in Chapter 13. The reason for this is the theoretical safeguard for Chapter 13 plans that requires a good faith effort to repay the debtor's disposable income to creditors. This is a requirement that does not exist in Chapter 7, hence the need for section 523(a) protection of debts that are presumed to have some special merit. With the Chapter 13 requirement of a good faith effort to repay, this protection is supposedly not needed.

The good faith requirement has not prevented the courts from confirming virtual no-payment plans (see section XIV. B. supra), thereby permitting some debtors to effectively conduct a liquidation under Chapter 13. This permits debtors to reap the benefits of a Chapter 7-like liquidation while taking advantage of the broader section 1328(a) discharge provision. Chapter 13 also permits the debtor to cease payment under the plan and seek an immediate discharge under the circumstances described in section 1328(b). But in such cases the debtor is limited to the normal discharge provisions, which prevent discharge of nine categories of debts as in Chapter 7.482 The plan can also be modified under section 1329 but

482. Id. at §§ 1328(c), 523(a).
such modification remains subject to the initial requirements for a plan under sections 1322, 1323 and 1325. If confirmation of the plan was procured by fraud such confirmation can be revoked upon request of any party in interest within 180 days. 483

In addition to the Chapter 7 exceptions to discharge in section 523, there are grounds for denial of a discharge in section 727 (applicable only to Chapter 7 cases). The latter include efforts to defraud creditors, falsify records, or commit a fraud upon the court. Unlike the section 523 exceptions, the section 727 offenses are a basis for denial of the entire discharge. In contrast, existence of a section 523 exception merely means that the particular debt will be non-dischargeable. As a practical matter the discharge provisions are most important in consumer cases, because a corporation cannot receive a discharge in any event. 484

XVI. A HYPOTHETICAL EXAMPLE ILLUSTRATING SOME OF THE DANGERS OF BANKRUPTCY FOR SECURED CREDITORS

Suppose that a Bank is an undersecured creditor of debtor (Bank’s collateral is worth less than the loan balance). Bank decides to bolster its position by arranging to collect the debtor’s accounts receivable, having the payments made directly to the Bank for distribution to the debtor and other creditors. That way the Bank can monitor the debtor’s operations and assure payment of the debtor’s other obligations. Debtor agrees and the arrangement is put into effect.

The Bank is notified by telephone that another creditor claims a subordinate mortgage or security interest in the Bank’s collateral, and the Bank officer who took the call assures the second mortgagee that the Bank will remit its payments from the funds being collected by the Bank. Unfortunately the Bank officer fails to carry through, having been momentarily distracted when the bank across the street was declared insolvent. For a period of about a year the Bank collects the debtor’s accounts receivable and distributes the money to the debtor and other creditors, except the second

483. Id. at § 1330.
484. Id. at § 727(a)(1).
mortgagee, who receives nothing. Finally, the debtor goes into bankruptcy. The Bank’s seemingly innocent and prudent behavior has in fact exposed it to considerable potential liability. Consider the following problems.

A. Insider Status

The Bank’s control of the debtor’s affairs, through its discretionary control over the debtor’s cash flow, qualifies the Bank as an insider under section 101(28) of the Bankruptcy Code. Although this does not always mean that the creditor’s claim will be subordinated, it does raise the possibility of subordination to the claims of all other creditors, under section 510 of the Bankruptcy Code.

B. Preferential Transfers

Since the Bank was an insider, all payments received in payment of unsecured debt within one year prior to bankruptcy will be considered preferential and can be set aside by the trustee. Very likely the bank will have to repay to the trustee all funds received from the debtor’s accounts receivable during that one year period, even though the bank no longer has the funds, having distributed most of the funds to the debtor and other creditors.

C. Liability to the Second Mortgagee

The Bank may be liable for its failure to pay to the subordinate mortgagee its share of the proceeds received from the debtor’s accounts receivable, even though it no longer has the funds.

D. Future Advances

As the Bank collected the debtor’s accounts it received payment of its claim against the debtor. This reduced accordingly the amount of the Bank’s secured claim against the debtor. As the Bank, at its discretion, remitted these funds to the debtor or his other creditors the Bank made additional loans to the debtor (future advances). Since these advances were discretionary, not obligatory, they were not secured by the Bank’s collateral, i.e., they were unsecured loans. The re-
result of the collection arrangement was to convert a portion of the Bank's debt from a secured priority claim to a subordinate unsecured claim.

In summary, the Bank may be liable to the trustee for the amount of funds collected during the one year period prior to bankruptcy, and may be liable again for the same amount to the second mortgagee. The Bank's claim to recover these funds from the recipients may be a general, unsecured claim subject to subordination or discharge in bankruptcy. The Bank's original, secured claim will have been reduced by the amount collected during the one year period. Regarding the amount collected during that one year, the Bank may have lost it three times over. Consider these possible lessons: (1) creditors should try to avoid exercising control of the debtor or otherwise becoming an insider; (2) creditors should not be afraid of receiving potentially preferential transfers but should be aware that they may have to return them; (3) creditors should not remit such funds to other parties; (4) creditors should be aware of other claims against the accounts, proceeds or collateral and should not violate the rights of other claimants; (5) creditors should be aware that receipt of payment from or on behalf of the debtor may constitute payment (and reduction) of a creditor's secured claim, even if the funds are subsequently remitted to someone else; and (6) creditors should be aware that remission of funds collected from or on behalf of the debtor may constitute future advances which will not be secured unless certain requirements are met.485

CONCLUSION

This article has detailed the lien rights of creditors and the impact of bankruptcy upon those rights in Oklahoma. While a secured creditor generally is in a preferred position relative to an unsecured creditor, a secured creditor nevertheless may face problems, particularly if a debtor is in or goes into bankruptcy. To the extent a creditor has a properly per-

485. This hopefully exaggerated hypothetical was inspired by the presentation of Gary H. Baker of Baker, Hoster, McSpadden, Clark and Rasure, of Tulsa, Oklahoma, at the Oklahoma City University School of Law Continuing Legal Education seminar, "The Troubled Oil Venture 1985," March 8, 1985, and by Continental Supply Co. v. Marshall, 152 F.2d 300 (10th Cir. 1945).
fected and prior security interest in a debtor’s property and to the extent the underlying property and other resources of a debtor are sufficient in value to satisfy a claim, a creditor should be able to recover the full amount thereof. On the other hand, if an unsecured creditor does not take the necessary steps to secure a lien upon the property of a debtor, an unsecured creditor has no recourse against the assets of a debtor in the event a debtor fails to pay a debt. Both secured and unsecured creditors face problems magnified in the event a debtor is in or goes into bankruptcy, which forces a creditor to compete with other parties for a limited amount of property. Additionally, both secured and unsecured creditors must successfully deal with other potentially fatal problems, such as the automatic stay and the trustee’s strong-arm powers. While a secured creditor’s interest may be problematical, the unsecured creditor’s interest usually is more so. Due to the possible consequences that may adversely affect an unsecured creditor in or out of bankruptcy, it behooves a creditor to protect its interest as much as possible by establishing a lien from the start of a relationship with a debtor, and to take the steps necessary to assure that the lien will have the desired priority status as against other creditors and a trustee in bankruptcy.