

MINUTES OF THE SENATE JUDICIARY COMMITTEE

The meeting was called to order by Chairman John Vratil at 9:30 A.M. on February 28, 2006, in Room 123-S of the Capitol.

All members were present except:

Les Donovan- excused
Greta Goodwin- excused
David Haley- excused

Committee staff present:

Mike Heim, Kansas Legislative Research Department
Helen Pedigo, Office of Revisor of Statutes
Karen Clowers, Committee Secretary

Conferees appearing before the committee:

Ed Cross, Kansas Independent Oil and Gas Association

Others attending:

See attached list.

The hearing on **HB 2104--UCC securities interest in oil and gas production** was opened.

The Chairman indicated this bill was heard last year but several changes had been made.

Ed Cross appeared as a proponent and provided background on the bill (Attachment 1). Mr. Cross indicated concern regarding producers and interest owners as unsecured general creditors and provided a balloon amendment with the requested changes. Mr. Cross stated that the proposed amendment also addressed the concerns of the Kansas Livestock Association and the Kansas Bankers Association.

Written testimony in support of **HB 2104** was submitted by:

Erick Nordling, Executive Secretary, Southwest Kansas Royalty Owners Association (Attachment 2)
Allie Devine, Vice President, Kansas Livestock Association (Attachment 3)

There being no further conferees, the hearing on **HB 2104** was closed.

The hearing on **HB 2562--Adoption; waiver of home study upon request of a relative of the child** was opened. The Chairman provided background on the bill. There were no conferees present.

The hearing on **HB 2562** was closed.

The hearing on **HB 2606--Theft of services** was opened. The Chairman provided background on the bill. There were no conferees present.

The hearing on **HB 2606** was closed.

The Chairman called for final action on **HB 2231--Defendant may petition the court to modify certain drug offense prison sentences to certified drug abuse treatment programs.**

The Chairman provided background on the bill which was heard on February 16. Following discussion, Senator Schmidt moved, Senator Allen seconded, to table **HB 2231.** Motion carried.

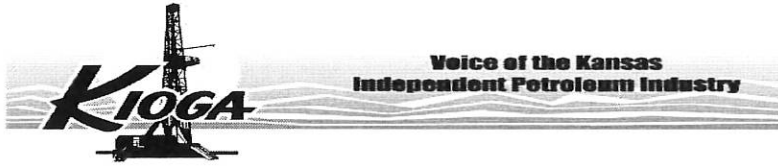
The meeting was adjourned at 10:04 a.m. The next scheduled meeting is March 1, 2006.

PLEASE CONTINUE TO ROUTE TO NEXT GUEST

SENATE JUDICIARY COMMITTEE GUEST LIST

DATE: 2-28-06

NAME	REPRESENTING
Lara Walsh	OJA
Kd Muf	LGR
MARK Borczyk	CAPITOR SPATIERS
Judy Shaw	KCTDA
Lynn Douglas	Hein Law Firm
Kathy Olsen	K&B Bankers
Jeff B. Henberg	Stok Farm
Brent Adkin	KLA
Tom Day	KCC
Ed Cross	KIOGA
Dong Smith	SWKROA
Natalie Gibson	KSC
Brenda Harman	KSC
PHILIP A. HURLEY	PAT HURLEY & CO.



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Testimony to the Senate Judiciary Committee
House Bill 2104 – An Act concerning the uniform commercial code;
concerning securities interests in oil and gas production

Edward P. Cross, Executive Vice President
Kansas Independent Oil & Gas Association

February 28, 2006

Good morning Chairman Vratil and members of the committee. I am Edward Cross, Executive Vice President of the Kansas Independent Oil & Gas Association (KIOGA). KIOGA represents the interests of independent oil and gas producers in Kansas. I am here today to express our support for House Bill 2104.

House Bill 2104 seeks to restore to the Kansas version of the Uniform Commercial Code (UCC), the provisions of repealed 82-9-319 (K.S.A. 84-9-319) as this statute was included in the UCC prior to its repeal. Thus, House Bill 2104 provides a security interest in favor of interest owners, including royalty interest owners (as secured parties) to secure the obligations of the first purchaser of oil and gas production (as debtor) to pay the purchase price. Among other provisions, the statute establishes that a signed writing giving the interest owner a right under real estate laws operated as a security agreement created under Article 9. Certain acts of the first purchaser, including signing an agreement to purchase oil or gas production or issuing a division order, operate as an authentication and adoption of the security agreement which was perfected automatically without the filing of a financing statement. The security interests are treated as purchase money security interests for purposes of determining their relative priority under the UCC.

It is important to note that House Bill 2104 is very similar to a provision of the UCC adopted by the State of Texas, namely TX Bus & Com Sec. 9.343. This Texas statute is attached hereto for ease of reference. The Texas statute is intended to provide protection for Texas oil and gas producers and their royalty and working interest owners under oil and gas leases via the granting a security interest in favor of the interest owner securing the obligations of the first pur-

Senate Judiciary

2-28-06

Attachment 1

chaser of oil or gas from the lease to pay the purchase price owed by the purchaser for the gas and/or oil purchased. House Bill 2104 does the same thing for Kansas oil and gas producers and their royalty and working interest owners. Oklahoma also has a similar statute to the Texas statute.

There are, of course, similarities and differences between oil and gas producers and their purchasers relative to sales of goods between other vendors and purchasers. As to the similarities, it should be noted that oil and gas (once severed from the ground) is defined as a good, the purchase and sale of which is governed in part by the UCC. Moreover, like sales of goods between other vendors-purchasers, the sale of oil and/or gas is a matter of contract between the seller and buyer.

However, the differences between oil and gas sales to purchasers relative to typical sales of goods should be noted. For example, in general, a purchaser of goods often has a relative few number of vendors of the inventory which these purchasers buy for ultimate sale to the purchaser's customers. However, every month, oil and gas purchasers purchase oil and/or gas from thousands of different leases which are operated by several hundred producers. These leases are owned by several thousand owners. The quantities purchased and the purchase price changes every month. The ownership of the oil and gas leases also change frequently. Moreover, unlike the typical vendor-purchaser relationship with respect to goods (which is generally static), the oil and gas purchasers to whom oil and/or gas is sold from a lease change frequently. Thus, the transactional cost of preparing, signing and filing security agreements and financing statements relative to the gas and/or oil purchased by purchasers from oil and gas leases would be very high.

It is therefore not surprising that security agreements and financing statements relative to the gas and/or oil purchased by purchasers are not typically filed as allowed by the UCC. The utter lack of leverage between a small Kansas oil and gas producer relative to their purchasers also contributes to the practical inability of Kansas oil and gas producers to obtain security agreements and financing statements relative to the gas and/or oil purchased by large oil and gas purchasers.

Moreover, when an oil and gas lease is drilled and a commercial well is discovered, oil and gas producers file an affidavit of production in the pertinent county offices. These affidavits are public notice that oil and/or gas is being produced from a certain lease in paying quantities. These affidavits are indexed in the office of the Register of Deeds of the pertinent county. In addition, the volumes of oil and gas purchased, the oil and gas lease involved, the oil and gas operator and purchaser involved, and other pertinent information are reported as a matter of public record by the first oil and gas purchaser to the Kansas Department of Revenue and such information is maintained by the Kansas Corporation Commission. This information would certainly be available to creditors of the oil and gas purchasers.

In view of these facts, KIOGA believes that House Bill 2104 provides Kansas oil and gas producers and their royalty and working interest owners reasonable protection from purchasers who may be able to take the produced oil and gas (which oil and gas is essential inventory in the matter of their maintaining their businesses) but treat the producer and their interest owners as unsecured general creditors as to the money owed. For example, when Farmland Industries, Inc., filed for protection under the United States Bankruptcy Code, several oil and gas producers who sold oil to Farmland immediately prior to the bankruptcy filing (on some occasions, with the oil being picked up from the tank batteries on the very day of the filing of the bankruptcy petition) would arguably be only general unsecured creditors with respect to the money owed them. This episode shows that a purchaser can take the oil and gas on the very day it files for protection under the United States Bankruptcy Code, and use this inventory to pay their secured creditors while leaving the oil and gas producer and its royalty interest owners as general unsecured creditors (who may thus be paid pennies on the dollar for the oil and gas sold). This result is unfair to the small oil and gas producer and its interest owners.

The provisions of House Bill 2104 would thus be of assistance to the many Kansas oil and gas producers and interest owners in these circumstances. It places Kansas producers and their interest owners on par with their counterparts in the States of Texas and Oklahoma relative to sales of oil and gas to purchasers. House Bill 2104 was reviewed by the Internal Civil Code Advisory Committee of the Kansas Judicial Council, which determined that it was a policy issue, that there were no procedural problems relative to the UCC, and that there no reason not to give the security position as advocated. KIOGA has worked with the Kansas Livestock Association (KLA) and the Kansas Bankers Association (KBA) to address specific concerns. As a result, we offer the amended HB 2104 as a bill that addresses the needs of KIOGA and the concerns of the KLA and KBA. KIOGA urges the enactment of House Bill 2104 by the Kansas legislature. Thank you for your time and consideration. I stand for questions.

V.T.C.A., Bus. & C. § 9.343

C

Effective: July 01, 2001

Vernon's Texas Statutes and Codes Annotated Currentness
Business and Commerce Code (Refs & Annos)
Title 1. Uniform Commercial Code (Refs & Annos)
 [Ⓢ] Chapter 9. Secured Transactions (Refs & Annos)
 [Ⓢ] Subchapter C. Perfection and Priority

⇒§ 9.343. Oil and Gas Interests: Security Interest Perfected Without Filing; Statutory Lien

(a) This section provides a security interest in favor of interest owners, as secured parties, to secure the obligations of the first purchaser of oil and gas production, as debtor, to pay the purchase price. An authenticated record giving the interest owner a right under real property law operates as a security agreement created under this chapter. The act of the first purchaser in signing an agreement to purchase oil or gas production, in issuing a division order, or in making any other voluntary communication to the interest owner or any governmental agency recognizing the interest owner's right operates as an authentication of a security agreement in accordance with Section 9.203(b) for purposes of this chapter.

(b) The security interest provided by this section is perfected automatically without the filing of a financing statement. If the interest of the secured party is evidenced by a deed, mineral deed, reservation in either, oil or gas lease, assignment, or any other such record recorded in the real property records of a county clerk, that record is effective as a filed financing statement for purposes of this chapter, but no fee is required except a fee that is otherwise required by the county clerk, and there is no requirement of refiling every five years to maintain effectiveness of the filing.

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

(1) for an unlimited time if:

(A) the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of those, although the sale of those proceeds by a first purchaser to a buyer in the ordinary course of business as provided in Subsection (e) cuts off the security interest in those proceeds;

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

(C) the proceeds are cash proceeds, as defined in Section 9.102; and

(2) for the length of time provided in Section 9.315 for all other proceeds.

(d) This section creates a lien that secures the payment of all taxes that are or should be withheld or paid by the first purchaser and a lien that secures the rights of any person who would be entitled to a security interest under Subsection (a) except for lack of any adoption of a security agreement by the first purchaser or a lack of possession or record required by Section 9.203 for the security interest to be enforceable.

V.T.C.A., Bus. & C. § 9.343

(e) The security interests and liens created by this section have priority over any purchaser who is not a buyer in the ordinary course of the first purchaser's business, but are cut off by the sale to a buyer from the first purchaser who is in the ordinary course of the first purchaser's business under Section 9.320(a). But in either case, whether or not the buyer from the first purchaser is in ordinary course, a security interest will continue in the proceeds of the sale by the first purchaser as provided in Subsection (c).

(f) The security interests and all liens created by this section have the following priorities over other Chapter 9 security interests:

(1) A security interest created by this section is treated as a purchase-money security interest for purposes of determining its relative priority under Section 9.324 over other security interests not provided for by this section. A holder of a security interest created under this section is not required to give the written notice every five years as provided in Section 9.324(b)(3) to have purchase-money priority over a security interest with a prior financing statement covering inventory.

(2) A statutory lien is subordinate to all other perfected Chapter 9 security interests and has priority over unperfected Chapter 9 security interests and the lien creditors, buyers, and transferees mentioned in Section 9.317.

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

(1) If a record effective as a filed financing statement under Subsection (b) exists, the security interests perfected by that record have priority over a security interest automatically perfected without filing under Subsection (b). If several security interests perfected by records exist, they have the same priority among themselves as established by real property law for interests in oil and gas in place. If real property law establishes no priority among them, they share priority pro rata.

(2) A security interest perfected automatically without filing under Subsection (b) has priority over a lien created under Subsection (d).

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

(h) The priorities for statutory liens mentioned in Section 9.333 do not apply to any security interest or statutory lien created by this section. But if a pipeline common carrier has a statutory or tariff lien that is effective and enforceable against a trustee in bankruptcy and not invalidated by the Federal Tax Lien Act, that lien has priority over the security interests and statutory liens created by this section.

(i) If oil or gas production in which there are security interests or statutory liens created by this section is commingled with inventory or other production, the rules of Section 9.336 apply.

(j) A security interest or statutory lien created by this section remains effective against the debtor and perfected against the debtor's creditors even if assigned, regardless of whether the assignment is perfected against the assignor's creditors. If a deed, mineral deed, assignment of oil and gas lease, or other such record evidencing the assignment is filed in the real property records of the county, it will have the same effect as filing an amended financing statement under Section 9.514.

V.T.C.A., Bus. & C. § 9.343

(k) This section does not impair an operator's right to set-off or withhold funds from other interest owners as security for or in satisfaction of any debt or security interest. In case of a dispute between an operator and another interest owner, a good faith tender of funds by anyone to the person who the operator and other interest owner agree on, to a person who otherwise shows himself or herself to be the one entitled to the funds, or to a court of competent jurisdiction in the event of litigation or bankruptcy operates as a tender of the funds to both.

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

(1) if the interest owner's rights are to oil or gas production or its proceeds, either to the operator alone, in which event the operator is considered the first purchaser, or to some combination of the interest owner and the operator, as the first purchaser chooses;

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

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

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

(1) by buying in the ordinary course of the first purchaser's business from the first purchaser under Section 9.320(a);

(2) by obtaining the interest owner's consent to the sale under Section 9.315(a)(1);

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

(4) by ensuring that the person or the first purchaser or some other person has withheld funds sufficient to pay amounts in dispute and has maintained a tender of those funds to whoever shows himself or herself to be the person entitled.

(n) If a tender under Subsection (m)(4) that is valid thereafter fails, the security interest and liens governed by this section remain effective.

(o) In addition to the usual remedy of sequestration available to secured parties, and the remedies given in Subchapter F, [FN1] the holders of security interests and liens created by this section have available to them, to the extent constitutionally permitted, the remedies of replevin, attachment, and garnishment to assist them in realizing upon their rights.

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

(q) The security interest created under Subsections (a) and (b) do not apply to proceeds of gas production that have been

V.T.C.A., Bus. & C. § 9.343

withheld, in cash or account form, by a purchaser under Section 201.204(c), Tax Code.

(r) In this section:

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

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

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

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

CREDIT(S)

Added by Acts 1999, 76th Leg., ch. 414, § 1.01, eff. July 1, 2001.

[FN1] V.T.C.A., Bus. & C. § 9.601 et seq.

STATE BAR COMMITTEE COMMENT

2002 Main Volume

1. Source. Former Section 9.319.

2. History. The 68th Legislature added the nonuniform predecessor of this section to Chapter 9 in 1983 (1983

HOUSE BILL No. 2104

By Committee on Judiciary

1-20

9 AN ACT concerning the uniform commercial code; concerning securities
10 interests in oil and gas production; amending K.S.A. 2004 Supp. 84-9-
11 324 and repealing the existing section.
12

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

14 New Section 1. (1) This section provides a security interest in favor
15 of interest owners (as secured parties) to secure the obligations of the
16 first purchaser of oil and gas production (as debtor) to pay the purchase
17 price. A signed writing giving the interest owner a right under real estate
18 law operates as a security agreement created under article 9 of chapter
19 84 of the Kansas Statutes Annotated, and amendments thereto. The act
20 of the first purchaser in signing an agreement to purchase oil or gas
21 production, in issuing a division order, or in making any other voluntary
22 communication to the interest owner or any governmental agency rec-
23 ognizing the interest owner's right operates as an authentication and
24 adoption of the security agreement in accordance with K.S.A. 84-1-
25 201(39), and amendments thereto.

26 ~~(2) The security interest provided by this section is perfected auto-~~
27 ~~matically without the filing of a financing statement. If the interest of the~~
28 ~~secured party is evidenced by a deed, mineral deed, reservation in either,~~
29 ~~oil or gas lease, assignment, or any other such writing recorded in the~~
30 ~~real estate records of a register of deeds, that writing is effective as a filed~~
31 ~~financing statement for purposes of K.S.A. 2004 Supp. 84-9-309, 84-9-~~
32 ~~310, 84-9-311, 84-9-312, 84-9-315, 84-9-322, 84-9-323, 84-9-324, 84-9-~~
33 ~~501, 84-9-502, 84-9-503, 84-9-504, 84-9-506, 84-9-507, 84-9-512, 84-9-~~
34 ~~515, 84-9-516, 84-9-519, 84-9-521, 84-9-522 and 84-9-525, and~~
35 ~~amendments thereto, but no fee is required except that otherwise re-~~
36 ~~quired by the register of deeds, and there is no requirement of refiling~~
37 ~~every five years to maintain effectiveness of the filing.~~

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

41 (a) For an unlimited time if:
42 (i) The proceeds are oil or gas production, inventory of raw, refined
43 or manufactured oil or gas production, or rights to or products of any of

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

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

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

6 (iii) the proceeds are cash proceeds; and

7 (b) for the length of time provided by K.S.A. 2004 Supp. 84-9-315,
8 and amendments thereto, as to all other proceeds.

9 (4) This section creates a lien that secures the payment of all taxes
10 that are or should be withheld or paid by the first purchaser, and a lien
11 that secures the rights of any person who would be entitled to a security
12 interest under subsection (a)(i) of this section except for lack of any adop-
13 tion of a security agreement by the first purchaser or a lack of possession
14 or writing required by K.S.A. 2004 Supp. 84-9-201 or 84-9-203, and
15 amendments thereto, for the security interest to be enforceable.

16 (5) The security interests and liens created by this section have pri-
17 ority over bona fide purchasers (transferees in bulk and other buyers not
18 in the ordinary course), but are cut off by the sale to a buyer from the
19 first purchaser in the ordinary course of the first purchaser's business
20 under K.S.A. 2004 Supp. 84-9-320, and amendments thereto, but in ei-
21 ther case, whether or not the buyer from the first purchaser is in the
22 ordinary course, a security interest will continue in the proceeds of the
23 sale by the first purchaser as provided in subsection (3).

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

26 (a) Security interests created by this section shall be treated as pur-
27 chase money security interests for purposes of determining their relative
28 priority under K.S.A. 2004 Supp. 84-9-322, 84-9-323 or 84-9-324, and
29 amendments thereto, ~~over other security interests not provided for by~~
30 ~~this section~~; holders of these security interests are not required to give
31 the written notices as provided by K.S.A. 2004 Supp. 84-9-324, and
32 amendments thereto, to enjoy purchase money priority over security in-
33 terests with a prior financing statement covering inventory; and

delete

34 (b) statutory liens are subordinate to all other perfected article se-
35 curity interests, and have priority over unperfected article security inter-
36 ests and the lien creditors, buyers and transferees mentioned in K.S.A.
37 2004 Supp. 84-9-317 or 84-9-323, and amendments thereto.

created by this section

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

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

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

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

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

9 (8) ~~The priorities for statutory liens mentioned in K.S.A. 2004 Supp.~~
10 ~~84-9-333, and amendments thereto, do not apply to any security interest~~
11 ~~or statutory lien created by this section.~~ But if any pipeline common
12 carrier has a statutory or tariff lien which is effective and enforceable
13 against a trustee in bankruptcy and not invalidated by the federal tax lien
14 act, it will have priority over the security interests and statutory liens
15 created by this section.

16 (9) If oil or gas production in which there are security interests or
17 statutory liens created by this section is commingled with inventory or
18 other production, the rules of K.S.A. 2004 Supp. 84-9-336, and amend-
19 ments thereto, apply.

20 (10) A security interest or statutory lien created by this section re-
21 mains effective against the debtor and perfected against the debtor's cred-
22 itors even if assigned, regardless of whether the assignment is perfected
23 against the assignor's creditors. If a deed, mineral deed, assignment of oil
24 or gas lease, or other such writing evidencing the assignment is filed in
25 the real estate records of the county, it will have the same effect as filing
26 an amended financing statement under K.S.A. 2004 Supp. 84-9-515, and
27 amendments thereto.

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

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

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

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

The statutory lien created by this section shall not be considered a "possessory lien" as defined by K.S.A. 2004 Supp. 84-9-333 and amendments thereto. The provisions of K.S.A. 2004 Supp. 84-9-333 and amendments thereto shall not apply to the statutory lien created by this section.

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

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

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

8 (a) By buying in the ordinary course of the first purchaser's business
9 from the first purchaser under K.S.A. 2004 Supp. 84-9-320, and amend-
10 ments thereto;

11 (b) by obtaining the interest owner's consent to the sale under K.S.A.
12 2004 Supp. 84-9-315 and amendments thereto;

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

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

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

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

31 (16) In this section:

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

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

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

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

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

36 Sec. 2. K.S.A. 2004 Supp. 84-9-324 is hereby amended to read as
37 follows: 84-9-324. (a) **General rule: purchase-money priority.** Except
38 as otherwise provided in subsection (g), a perfected purchase-money se-
39 curity interest in goods other than inventory or livestock has priority over
40 a conflicting security interest in the same goods, and, except as otherwise
41 provided in K.S.A. 2004 Supp. 84-9-327 and amendments thereto, a per-
42 fected security interest in its identifiable proceeds also has priority, if the
43 purchase-money security interest is perfected when the debtor receives

1 possession of the collateral or within 20 days thereafter.

2 (b) **Inventory purchase-money priority.** Subject to subsection (c)
3 and except as otherwise provided in subsection (g), a perfected purchase-
4 money security interest in inventory has priority over a conflicting security
5 interest in the same inventory, has priority over a conflicting security
6 interest in chattel paper or an instrument constituting proceeds of the
7 inventory and in proceeds of the chattel paper, if so provided in K.S.A.
8 2004 Supp. 84-9-330 and amendments thereto, and, except as otherwise
9 provided in K.S.A. 2004 Supp. 84-9-327 and amendments thereto, also
10 has priority in identifiable cash proceeds of the inventory to the extent
11 the identifiable cash proceeds are received on or before the delivery of
12 the inventory to a buyer, if:

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

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

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

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

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

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

30 (2) if the purchase-money security interest is temporarily perfected
31 without filing or possession under K.S.A. 2004 Supp. 84-9-312(f) and
32 amendments thereto, before the beginning of the 20-day period
33 thereunder.

34 (d) **Livestock purchase-money priority.** Subject to subsection (e)
35 and except as otherwise provided in subsection (g), a perfected purchase-
36 money security interest in livestock that are farm products has priority
37 over a conflicting security interest in the same livestock, and, except as
38 otherwise provided in K.S.A. 2004 Supp. 84-9-327 and amendments
39 thereto, a perfected security interest in their identifiable proceeds and
40 identifiable products in their unmanufactured states also has priority, if:

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

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

- 1 fication to the holder of the conflicting security interest;
- 2 (3) the holder of the conflicting security interest receives the notifi-
- 3 cation within six months before the debtor receives possession of the
- 4 livestock; and
- 5 (4) the notification states that the person sending the notification has
- 6 or expects to acquire a purchase-money security interest in livestock of
- 7 the debtor and describes the livestock.
- 8 (e) **Holders of conflicting livestock security interests to be no-**
- 9 **tified.** Subsections (d)(2) through (4) apply only if the holder of the con-
- 10 flicting security interest had filed a financing statement covering the same
- 11 types of livestock:
- 12 (1) If the purchase-money security interest is perfected by filing, be-
- 13 fore the date of the filing; or
- 14 (2) if the purchase-money security interest is temporarily perfected
- 15 without filing or possession under K.S.A. 2004 Supp. 84-9-312(f) and
- 16 amendments thereto, before the beginning of the 20-day period
- 17 thereunder.
- 18 (f) **Software purchase-money priority.** Except as otherwise pro-
- 19 vided in subsection (g), a perfected purchase-money security interest in
- 20 software has priority over a conflicting security interest in the same col-
- 21 lateral, and, except as otherwise provided in K.S.A. 2004 Supp. 84-9-327
- 22 and amendments thereto, a perfected security interest in its identifiable
- 23 proceeds also has priority, to the extent that the purchase-money security
- 24 interest in the goods in which the software was acquired for use has
- 25 priority in the goods and proceeds of the goods under this section.
- 26 (g) **Conflicting purchase-money security interests.** If more than
- 27 one security interest qualifies for priority in the same collateral under
- 28 subsection (a), (b), (d), or (f):
- 29 (1) A security interest securing an obligation incurred as all or part
- 30 of the price of the collateral has priority over a security interest securing
- 31 an obligation incurred for value given to enable the debtor to acquire
- 32 rights in or the use of collateral; and
- 33 (2) in all other cases, K.S.A. 2004 Supp. 84-9-322(a) and amendments
- 34 thereto applies to the qualifying security interests.
- 35 Sec. 3. K.S.A. 2004 Supp. 84-9-324 is hereby repealed.
- 36 Sec. 4. This act shall take effect and be in force from and after its
- 37 publication in the statute book.

1-14

Southwest Kansas Royalty Owners Association

209 East Sixth Street
Hugoton, Kansas 67951

Testimony before the Senate Judiciary Committee House Bill 2104 February 28, 2006

Chairman Vratil and Members of the Senate Judiciary Committee:

My name is Erick E. Nordling, of Hugoton, Kansas. I am a lawyer and a member of the Hugoton law firm of Kramer, Nordling, & Nordling, LLC. I have practiced law for twenty years and have spent my entire legal career representing landowners. I am currently serving as Executive Secretary of the Southwest Kansas Royalty Owners Association (SWKROA). That Association's mission is the protection of the rights of royalty owners in the Hugoton Gas Field in southwest Kansas. The voluntary association has over 2,600 members and on behalf of its members and Kansas royalty owners **supports the passage of House Bill 2104.**

From time to time, the oil and gas industry in Kansas has experienced hard economic and financial times. An operator's financial distress is seldom confined to its own financial statement, but rather clearly impacts the financial welfare of others. In many instances, the law in Kansas provides some level of protection for those affected. For example, if an operator fails to pay a drilling contractor or the supplier of pipes for his well, those suppliers of materials and services can acquire a lien on the oil and gas leasehold estate of the nonpaying operator. Those lien rights are provided in K.S.A. 55-207, et seq.

It is not, however, only the supplier who feels the operator's financial strain. An operator who cannot pay his supplier will most likely fail to pay the royalty owner and other working interest owners who are entitled to proceeds from the production of oil and gas. There is, however, no Kansas statute to protect their rights, as in the case of a supplier. If an operator files for bankruptcy, these interest owners are mere unsecured creditors who generally receive nothing for their unsecured claims in a bankruptcy. House Bill No. 2104 is designed to correct that problem.

House Bill 2104 provides a security interest to both royalty and working interest owners, as secured parties, in oil and gas production, as defined in the Bill, and the proceeds therefrom, to secure the obligations of the first purchaser. In 1991 the Kansas Legislature adopted a comparable bill (Senate Bill No. 12, from the Session of 1991). However, in 2000, following a nationwide trend to overhaul Article 9 of the Uniform Commercial Code to keep the code uniform among the states, the Kansas Legislature deleted these protective provisions. There is still a need for a statutory security interest for unsecured creditors entitled to proceeds from oil and gas production.

The Bill's approach is simple.

Senate Judiciary

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Attachment 2

A signed division order, agreement to purchase oil or gas production or other writing recognizing the interest owners' interest is sufficient to serve as security agreement between the interest owner and the first purchaser and automatically perfects the interest owners' interest. (Section 1). If the interest is evidenced by a recorded deed, mineral deed, reservation in either, oil or gas lease, assignment or other writing, that writing serves as a filed financing statement. The writings, whether recorded or not, serve to create a security interest in oil and gas production, as well as any proceeds therefrom. No other filing is required, simplifying the manner in which the interest is obtained and detected. (Sections 2 and 3).

The security interest created serves to protect the interest owner in the event of a bankruptcy filing, by elevating the status of the interest owner to that of a secured creditor - a position that those unfamiliar with bankruptcy law might have assumed the interest owner already occupied.

The relative priorities of the various interest owners among themselves and with respect to other creditors are also set forth in the Bill (Sections 7 and Sections 6 and 8, respectively).

If a dispute arises among the interest owners and the first purchaser, the Bill provides for the manner in which the dispute can be resolved, which protects both the interest owner and the first purchaser. (Sections 11 and 12).

Likewise, the rights of buyer in the ordinary course of business will find that his rights have not been impaired by the Bill. (Sections 5 and 13). He retains his ability to buy oil and gas production free and clear of any liens. The Bill, to the extent possible, protects the rights of those who, until now, were long forgotten, while at the same time leaving essentially undisturbed the sale of oil and gas to others.

On behalf of the Southwest Kansas Royalty Owners Association, I urge that the Legislature of the State of Kansas to enact House Bill No. 2104.

Respectfully submitted,

/s/ Erick E. Nordling

Erick E. Nordling
Executive Secretary, SWKROA



Since 1894

Testimony

To: Senate Judiciary Committee
Senator John Vratil, Chair

From: Allie Devine, Vice President and General Counsel

Date: January 25, 2006

Re: HB 2104

The Kansas Livestock Association (KLA), formed in 1894, is a trade association representing over 6,000 members on legislative and regulatory issues. KLA members are involved in many aspects of the livestock industry, including seed stock, cow-calf and stocker production, cattle feeding, grazing land management and diversified farming operations.

The Kansas Livestock Association has supported the application of the Uniform Commercial Code and was an active participant in the revisions in 2000. During the discussions in 2000, it was determined that statutory liens would retain their priority status.

KLA opposes HB 2104 as it is an attempt to rewrite the provisions of K.S.A. 84-9-317, 323, and 333. Statutory liens are provisions of law that give preference to certain transactions by virtue of law and the nature of the transaction.

K.S.A. 58-207 provides that unpaid keepers of livestock are given a lien in the livestock for costs incurred during the care and maintenance of the livestock. This statutory lien is given priority over other liens pursuant to K.S.A. 84-9-333. There is a long history of the use of statutory liens in the cattle industry. The Uniform Commercial Code was designed to provide a basis of law for the business community. The cattle industry has relied upon these statutory protections in the course of their businesses. Any changes to the priority system would greatly disrupt the course of business known throughout the industry.

HB 2104 section 6(b) {p.2 l.34-37} and section 8 {p. 3, l. 9-11} are confusing. The provisions combine the concepts of a security interest and a lien. From my conversations with Mr. David Nickel, it appears that the intent of the drafters was to create a statutory lien that would compete with all other statutory liens in the priority scheme of the UCC. Further, it appears that the intent of the framers was to make clear that the statutory lien

Senate Judiciary

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created was NOT a "possessory lien" as referenced in K.S.A. 84-9-333. There was no intent to interfere or change the priority status of statutory liens. (See attached email from Mr. David Nickel) I will defer to others to discuss the creation of a security interest that does not require filing. I have drafted some proposed changes and will be circulating these to the interested parties for review.

We would welcome the opportunity to work with the committee to clarify the language. Thank you.

Allie Devine

From: David Nickel [david_n@depewgillen.com]
Sent: Tuesday, January 24, 2006 5:27 PM
To: Allie Devine
Cc: Ed Cross
Subject: HB 2104

Dear Allie:

Thanks for your call. Section 6 of House Bill 2104 refers to the statutory lien created by Section 4 of the House Bill. It does not refer to other statutory liens. Section 8 makes clear that the priorities for statutory liens referenced in UCC 9-333 do not apply to the statutory lien created by Section 4. Call if you have any other questions. Thanks again. David Nickel

PS. Sorry this is later than I thought I would be able to send it. Our server broke down.

HOUSE BILL No. 2104

By Committee on Judiciary

1-20

9 AN ACT concerning the uniform commercial code; concerning securities
10 interests in oil and gas production; amending K.S.A. 2004 Supp. 84-9-
11 324 and repealing the existing section.
12

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

14 New Section 1. (1) This section provides a security interest in favor
15 of interest owners (as secured parties) to secure the obligations of the
16 first purchaser of oil and gas production (as debtor) to pay the purchase
17 price. A signed writing giving the interest owner a right under real estate
18 law operates as a security agreement created under article 9 of chapter
19 84 of the Kansas Statutes Annotated, and amendments thereto. The act
20 of the first purchaser in signing an agreement to purchase oil or gas
21 production, in issuing a division order, or in making any other voluntary
22 communication to the interest owner or any governmental agency rec-
23 ognizing the interest owner's right operates as an authentication and
24 adoption of the security agreement in accordance with K.S.A. 84-1-
25 201(39), and amendments thereto.

26 (2) The security interest provided by this section is perfected auto-
27 matically without the filing of a financing statement. If the interest of the
28 secured party is evidenced by a deed, mineral deed, reservation in either,
29 oil or gas lease, assignment, or any other such writing recorded in the
30 real estate records of a register of deeds, that writing is effective as a filed
31 financing statement for purposes of K.S.A. 2004 Supp. 84-9-309, 84-9-
32 310, 84-9-311, 84-9-312, 84-9-315, 84-9-322, 84-9-323, 84-9-324, 84-9-
33 501, 84-9-502, 84-9-503, 84-9-504, 84-9-506, 84-9-507, 84-9-512, 84-9-
34 515, 84-9-516, 84-9-519, 84-9-521, 84-9-522 and 84-9-525, and
35 amendments thereto, but no fee is required except that otherwise re-
36 quired by the register of deeds, and there is no requirement of refileing
37 every five years to maintain effectiveness of the filing.

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

41 (a) For an unlimited time if:

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

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

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

6 (iii) the proceeds are cash proceeds; and

7 (b) for the length of time provided by K.S.A. 2004 Supp. 84-9-315,
8 and amendments thereto, as to all other proceeds.

9 (4) This section creates a lien that secures the payment of all taxes
10 that are or should be withheld or paid by the first purchaser, and a lien
11 that secures the rights of any person who would be entitled to a security
12 interest under subsection (a)(i) of this section except for lack of any adop-
13 tion of a security agreement by the first purchaser or a lack of possession
14 or writing required by K.S.A. 2004 Supp. 84-9-201 or 84-9-203, and
15 amendments thereto, for the security interest to be enforceable.

16 (5) The security interests and liens created by this section have pri-
17 ority over bona fide purchasers (transferees in bulk and other buyers not
18 in the ordinary course), but are cut off by the sale to a buyer from the
19 first purchaser in the ordinary course of the first purchaser's business
20 under K.S.A. 2004 Supp. 84-9-320, and amendments thereto, but in ei-
21 ther case, whether or not the buyer from the first purchaser is in the
22 ordinary course, a security interest will continue in the proceeds of the
23 sale by the first purchaser as provided in subsection (3).

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

26 (a) Security interests created by this section shall be treated as pur-
27 chase money security interests for purposes of determining their relative
28 priority under K.S.A. 2004 Supp. 84-9-322, 84-9-323 or 84-9-324, and
29 amendments thereto, ~~over other security interests not provided for by~~
30 ~~this section~~; holders of these security interests are not required to give
31 the written notices as provided by K.S.A. 2004 Supp. 84-9-324, and
32 amendments thereto, to enjoy purchase money priority over security in-
33 terests with a prior financing statement covering inventory; and

delete

34 (b) statutory liens are subordinate to all other perfected article se-
35 curity interests, and have priority over unperfected article security inter-
36 ests and the lien creditors, buyers and transferees mentioned in K.S.A.
37 2004 Supp. 84-9-317 or 84-9-323, and amendments thereto.

created by this section

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

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

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

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

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

9 (8) ~~The priorities for statutory liens mentioned in K.S.A. 2004 Supp.~~
10 ~~84-9-333, and amendments thereto, do not apply to any security interest~~
11 ~~or statutory lien created by this section.~~ But if any pipeline common
12 carrier has a statutory or tariff lien which is effective and enforceable
13 against a trustee in bankruptcy and not invalidated by the federal tax lien
14 act, it will have priority over the security interests and statutory liens
15 created by this section.

16 (9) If oil or gas production in which there are security interests or
17 statutory liens created by this section is commingled with inventory or
18 other production, the rules of K.S.A. 2004 Supp. 84-9-336, and amend-
19 ments thereto, apply.

20 (10) A security interest or statutory lien created by this section re-
21 mains effective against the debtor and perfected against the debtor's cred-
22 itors even if assigned, regardless of whether the assignment is perfected
23 against the assignor's creditors. If a deed, mineral deed, assignment of oil
24 or gas lease, or other such writing evidencing the assignment is filed in
25 the real estate records of the county, it will have the same effect as filing
26 an amended financing statement under K.S.A. 2004 Supp. 84-9-515, and
27 amendments thereto.

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

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

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

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

The statutory lien created by this section shall not be considered a "possessory lien" as defined by K.S.A. 2004 Supp. 84-9-33 and amendments thereto. The provisions of K.S.A. 2004 Supp. 84-9-33, and amendments thereto shall not apply to the statutory lien created by this section.

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

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

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

8 (a) By buying in the ordinary course of the first purchaser's business
9 from the first purchaser under K.S.A. 2004 Supp. 84-9-320, and amend-
10 ments thereto;

11 (b) by obtaining the interest owner's consent to the sale under K.S.A.
12 2004 Supp. 84-9-315 and amendments thereto;

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

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

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

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

31 (16) In this section:

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

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

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

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

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

36 Sec. 2. K.S.A. 2004 Supp. 84-9-324 is hereby amended to read as
37 follows: 84-9-324. (a) **General rule: purchase-money priority.** Except
38 as otherwise provided in subsection (g), a perfected purchase-money se-
39 curity interest in goods other than inventory or livestock has priority over
40 a conflicting security interest in the same goods, and, except as otherwise
41 provided in K.S.A. 2004 Supp. 84-9-327 and amendments thereto, a per-
42 fected security interest in its identifiable proceeds also has priority, if the
43 purchase-money security interest is perfected when the debtor receives

1 possession of the collateral or within 20 days thereafter.

2 (b) **Inventory purchase-money priority.** Subject to subsection (c)
3 and except as otherwise provided in subsection (g), a perfected purchase-
4 money security interest in inventory has priority over a conflicting security
5 interest in the same inventory, has priority over a conflicting security
6 interest in chattel paper or an instrument constituting proceeds of the
7 inventory and in proceeds of the chattel paper, if so provided in K.S.A.
8 2004 Supp. 84-9-330 and amendments thereto, and, except as otherwise
9 provided in K.S.A. 2004 Supp. 84-9-327 and amendments thereto, also
10 has priority in identifiable cash proceeds of the inventory to the extent
11 the identifiable cash proceeds are received on or before the delivery of
12 the inventory to a buyer, if:

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

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

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

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

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

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

30 (2) if the purchase-money security interest is temporarily perfected
31 without filing or possession under K.S.A. 2004 Supp. 84-9-312(f) and
32 amendments thereto, before the beginning of the 20-day period
33 thereunder.

34 (d) **Livestock purchase-money priority.** Subject to subsection (e)
35 and except as otherwise provided in subsection (g), a perfected purchase-
36 money security interest in livestock that are farm products has priority
37 over a conflicting security interest in the same livestock, and, except as
38 otherwise provided in K.S.A. 2004 Supp. 84-9-327 and amendments
39 thereto, a perfected security interest in their identifiable proceeds and
40 identifiable products in their unmanufactured states also has priority, if:

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

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

1 fication to the holder of the conflicting security interest;

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

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

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

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

14 (2) if the purchase-money security interest is temporarily perfected
15 without filing or possession under K.S.A. 2004 Supp. 84-9-312(f) and
16 amendments thereto, before the beginning of the 20-day period
17 thereunder.

18 (f) **Software purchase-money priority.** Except as otherwise pro-
19 vided in subsection (g), a perfected purchase-money security interest in
20 software has priority over a conflicting security interest in the same col-
21 lateral, and, except as otherwise provided in K.S.A. 2004 Supp. 84-9-327
22 and amendments thereto, a perfected security interest in its identifiable
23 proceeds also has priority, to the extent that the purchase-money security
24 interest in the goods in which the software was acquired for use has
25 priority in the goods and proceeds of the goods under this section.

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

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

33 (2) in all other cases, K.S.A. 2004 Supp. 84-9-322(a) and amendments
34 thereto applies to the qualifying security interests.

35 Sec. 3. K.S.A. 2004 Supp. 84-9-324 is hereby repealed.

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