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UNASSIGNED OIL AND GAS INTERESTS IN BANKRUPTCY

Tony M. Davis*

I. INTRODUCTION

In oil and gas bankruptcy proceedings, disputes frequently arise between non-debtor entities seeking to enforce pre-petition rights to receive assignments of oil and gas working interests and bankruptcy trustees seeking to retain these interests for the benefit of the estate's creditors. The Trustee will typically seek to retain such interests by characterizing the non-debtor entity's right to receive an assignment as a property right which, if not of record, can be "avoided" under section 544 of the Code, or as a contract right which can be "rejected" under...
section 365 of the Code. Analysis of the non-debtor entity’s ability to withstand the Trustee's attack is complex, in part because of the uncertain characterization of oil and gas working interests under state law, particularly in Oklahoma, but also because of the uncertain application of sections 544 and 365 to rights to receive assignments in general.

II. STRONG-ARM ANALYSIS

A. Overview of Trustee’s Strong-Arm Powers

In addition to the Trustee’s power to reject executory contracts and to set aside preferential and fraudulent transfers, additional powers under section 544 enable the Trustee to marshal and increase potential assets of the estate. These powers have resulted in the characterization of section 544 as the “Strong-Arm Clause.” As one commentator noted:

[The provision was designed from the beginning to strike down secret liens and other transfers that prior thereto had evaded the trustee's attack . . . .] whereunder the applicable law such a creditor or bona fide purchaser might prevail over prior transfers, liens, encumbrances or the like, the trustee will also prevail.

[6. See infra notes 61-69 and accompanying text.]

7. Excellent general discussions of this and other oil and gas insolvency law issues can be found in Baker & Schiffman, Effect of Bankruptcy Law on Specific Oil and Gas Insolvency Problems, 35 INST. ON OIL & GAS L. & TAX’N 187 (1984); and Gandy, Creditors' Rights and the Oil and Gas Venture for the Nonbankruptcy Expert, 34 INST. ON OIL & GAS L. & TAX’N 1 (1983).


10. Section 544(a) provides that:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

Id. § 544(a).

11. 4 COLLIER ON BANKRUPTCY ¶¶ 544-1, at 544-3 (15th ed. Supp. 1985) (footnotes omitted)
The "strong-arm power" of section 544 empowers the Trustee to assume the rights of a judicial lien creditor. The judicial lien afforded to the Trustee includes a lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding. Thus, while the Trustee may not obtain a judgment lien on an oil and gas lease, the Trustee would presumably be able to obtain a lien through execution and levy.

An additional "strong-arm power" bestows the Trustee with the rights of a creditor who has had an execution returned unsatisfied. Thus, under state laws, such as Oklahoma, which require that the execution first be delivered against goods and chattels and thereafter on the realty if the levy was unsuccessful, the Trustee will be deemed to have had his execution already directed against the goods and chattels and returned unsatisfied.

*Brent Explorations, Inc. v. Karst Enterprises, Inc. (In re Brent Explorations, Inc.)* provides an example of the application of the Trustee's strong-arm powers to the oil and gas industry. In *Brent*, the debtor assigned production proceeds from an oil and gas well to a trade supplier, Karst, in exchange for lien releases. Karst agreed not to record the assignment so that the purchaser would not suspend production. Payments were made pursuant to the assignment up until shortly before bankruptcy. Subsequent to bankruptcy, the Trustee asserted the strong-arm powers as a means of avoiding the assignment.

The court indicated that it was unable to determine whether the assignment of production constituted real or personal property. However, the court concluded that if it was real property, the assignment would have to be recorded to defeat the Trustee's status under subsection 544(a)(3). If the assignment was personal property, a financing state-
ment would have to be filed under Wyoming's version of Article 9 of the Uniform Commercial Code in order to defeat the Trustee's status under subsection 544(a)(1). The court found that the assignment was neither recorded nor perfected and was thus inferior to the Trustee's status under subsection 544(a).

B. Bona Fide Purchaser of Real Property

The Trustee's strong-arm powers were strengthened considerably by the 1978 Amendments with the addition of subsection 544(a)(3), which confers upon the Trustee the status of a bona fide purchaser of real property. This new provision is particularly significant in Oklahoma, where the status enjoyed by bona fide purchasers is greater than that enjoyed by judicial lienholders. In applying subsection 544(a)(3), the first issue to be addressed is whether an oil and gas lease would be considered real property for purposes of this subsection.

In Kenan v. Hilliard Oil and Gas, Inc. (In re George Rodman, Inc.), the bankruptcy court allowed the Trustee to avoid an improperly perfected operator's lien under the provisions of subsection 544(a)(3), although the issue of whether subsection 544(a)(3) was even applicable to oil and gas leases was not raised. In Busby v. U.S. Steel Corp., the court addressed the issue of whether the execution of an assignment of oil and gas leases constituted a transfer for purposes of preference law, or whether the transfer occurred when the instrument was recorded. The district court observed that transfers of interests in oil and gas leases under Oklahoma law must be recorded to defeat bona fide purchasers. The court concluded that because a bona fide purchaser could obtain from the debtor a transfer of the rights in the leases superior to the rights of the transferee at any time prior to the date of the recording of the assignments to the transferee, there was no actual transfer under the preference section until the assignments from the debtor to the defendant

20. See, e.g., Buell Cabinet Co. v. Sudduth, 608 F.2d 431, 435 (10th Cir. 1979) (recording statutes exist to protect bona fide purchasers, not judicial lienholders); Carroll v. Holliman (In re Holliman Drilling Co.), 336 F.2d 425, 429 (10th Cir. 1964), cert. denied, 380 U.S. 907 (1965) (while an unrecorded mortgage of oil and gas leases can be defeated by a bona fide purchaser, it is superior to the Trustee's position as a mere lien creditor).
were recorded. The analysis in Busby should have an even stronger application to subsection 544(a)(3). The Trustee's strong-arm powers, including his status as a bona fide purchaser, expressly target unrecorded transfers, and conveyances of oil and gas leases in Oklahoma must be recorded to defeat bona fide purchasers. Thus, the argument is strong that oil and gas leases would be classified as real property for purposes of subsection 544(a)(3). Using a similar analysis, the court in D & F Petroleum v. Cascade Oil Co. (In re Cascade Oil Co.) concluded that oil and gas leasehold interests in Kansas should be treated as real property for purposes of subsection 544(a)(3).

C. Defenses to Avoidance: Subsection 541(d) and Constructive Trusts

The 1978 Amendments also included subsection 541(d), which appears to provide some protection to holders of interests in property who do not have record title reflecting their ownership. The legislative his-

24. Id. at 607-08 (citing Gamble v. Cornell Oil Co., 260 F.2d 860, 868 (10th Cir. 1958); Davis v. Lewis, 187 Okla. 91, 93, 100 P.2d 994, 996 (1940)). The preference provision in question was § 96, the predecessor to § 547(e)(1)(A), providing that "a transfer of real property shall be deemed to have been made... when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee." 11 U.S.C. § 96 (1976), amended by 11 U.S.C. § 547(e)(1)(A) (1982).

25. COLLIER, supra note 11, at 544-45.

26. See Gamble, 260 F.2d at 868; Davis, 187 Okla. at 93, 100 P.2d at 996; see also Stone v. Wright, 75 F.2d 457, 460 (10th Cir.), cert. denied, 295 U.S. 754 (1935).

27. 65 Bankr. 35 (Bankr. D. Kan. 1986). The court rejected the idea that its decision was inconsistent with In re J.H. Land & Cattle Co., 8 Bankr. 237 (Bankr. W.D. Okla. 1981), see infra notes 107-09 and accompanying text, on the basis that oil and gas interests in Kansas are categorized as real or personal depending on the purpose of the classification. Cascade, 65 Bankr. at 41 n.11.

28. Cascade, 65 Bankr. at 41. The Trustee must also, however, establish his status as a bona fide purchaser. It is well established that the language in § 544(a) "without regard to any knowledge of the Trustee" refers to the personal knowledge or actual notice that the Trustee might have, but not to constructive notice. The Trustee's status as a bona fide purchaser may be defeated if, under applicable state law, constructive notice exists of the interest sought to be avoided. See, e.g., McCannon v. Marston, 679 F.2d 13, 16-17 (3d Cir. 1982); Sapho v. Walsh (In re Gurs), 27 Bankr. 163, 165 (Bankr. 9th Cir. 1983); Maine Nat'l Bank v. Morse (In re Morse), 30 Bankr. 52, 54 (Bankr. 1st Cir. 1983). But see Pyne v. Hartman Paving, Inc. (In re Hartman Paving, Inc.), 745 F.2d 307, 310 (4th Cir. 1984). Oklahoma statutory law provides that “[c]onstructive notice is notice imputed by the law to a person not having actual notice.” OKLA. STAT. tit. 25, § 13 (1981). Also, a person with actual notice of circumstances that would lead a prudent person to inquire as to a particular fact, who fails to make such inquiry with reasonable diligence, will be deemed to have constructive notice of the fact itself. Id. § 13; Burgess v. Ind. School Dist. No. 1, 336 P.2d 1077, 1080-81 (Okla. 1959).

29. The full text of 11 U.S.C. § 541(d) provides:
tory makes it clear that the purpose of subsection 541(d) is to shield secondary mortgage market sales from the Trustee’s avoidance powers. Consequently, the application of subsection 541(d) to secondary mortgage market sales is well established. The statute and legislative history appear to use the secondary mortgage market only as an example. Thus, there is an issue as to whether Congress intended that subsection 541(d) have a broader application. In *Beutal v. Joanis (In re Investment Sales Diversified, Inc.)*, the bankruptcy court concluded that subsection 541(d) was only applicable where the debtor originates first mortgages and then sells those mortgages to investors in a national market.

One case has extended the application of subsection 541(d) to unrecorded oil and gas interests. In *Official Creditors' Committee of Partners Oil Co. v. Partners Oil Co. (In re Partners Oil Co.)*, numerous assignments of royalties and working interests from the debtor to certain overriding royalty and working interest owners had not been recorded when

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Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.


30. Relevant portions of the legislative history provide:

The Seller of mortgages in the secondary mortgage market will often retain the original mortgage notes and related documents and the seller will not endorse the notes to reflect the sale to the purchaser. Similarly, the purchaser will often not record the purchaser's ownership of the mortgages or interests in mortgages under State recording statutes. These facts are irrelevant and the seller's retention of the mortgaged documents and the purchaser's decision not to record do not change the trustee's obligation to turn the mortgages or interest in mortgages over to the purchaser.

The purpose of § 541(d) as applied to the secondary mortgage market is therefore to make certain that secondary market sales as they are currently structured are not subject to challenge by bankruptcy trustees . . . .


32. An excellent discussion of this issue, as applied to oil and gas leasehold interests, is contained in *Unrecorded Oil and Gas Interests, a Special Problem for the Unwary, 1986: Subcomm. of the Business Bankruptcy Comm.* (see 6 Bus. Law., May-June 1986, for information on how to obtain copies).


the bankruptcy proceedings commenced. The Creditors' Committee filed an adversary proceeding seeking a preliminary injunction requiring the debtor to escrow all royalty and production run payments to the unrecorded interest owners until their entitlement to such revenues could be determined. The court found that the unrecorded interest owners had paid in full or earned in full their interests, that legal title to the interests in question was held by the debtor, but that the unrecorded interest owners held equitable title to the interests in question.\footnote{Id. at 2.} Additionally, the court found that subsection 541(d) is not limited to the secondary mortgage market, but extends to industries where "substantial industry practice and good reason exist to warrant the retention of legal title by the debtor to service the underlying real property for the benefit of the equitable title owners."\footnote{Partners Oil, slip. op. at 2.} The court determined that in the oil and gas industry, legal title to oil and gas leases is retained by operators so that they can:

(a) efficiently sell the production from the wells;
(b) efficiently police defaults by investors;
(c) avoid unnecessary filings if the well is not commercially productive;
(d) efficiently enter into pooling and unitization agreements;
(e) efficiently pay taxes on the property; and
(f) avoid holding up development until all leases are purchased.\footnote{Id. at 3.}

The court concluded that subsection 541(d) applies to the oil and gas industry,\footnote{Id. at 3-4.} and denied the request for a preliminary injunction on the basis that the Creditors' Committee did not establish a sufficient probability of recovering on the merits.\footnote{Id. at 3-4.} The court determined that § 541(d) acted as a limitation on § 544, but cautioned that this determination was being made only in the context of deciding the preliminary injunction matters at issue.\footnote{Id. at 2.}

\begin{itemize}
\item 36. Id. at 2. Section 365 was probably not available to the Trustee because the debtor had performed under the contract to make the assignment. See infra notes 83-92 and accompanying text. Where the assignment has not yet been made, § 544 would still be available, to the extent not limited by § 541(d), because the purchaser holds an unrecorded equitable interest. Manley v. Fong, 734 F.2d 1415, 1419 (10th Cir. 1984).
\item 37. Partners Oil, slip. op. at 2.
\item 38. Id. at 3.
\item 39. Id.
\item 40. Id. at 3-4. The court determined that § 541(d) acted as a limitation on § 544, but cautioned that this determination was being made only in the context of deciding the preliminary injunction matters at issue.
\item 41. 37 Bankr. 530 (Bankr. W.D. Okla. 1984).
\item 42. 56 Bankr. 776 (E.D. La. 1986).
\end{itemize}
exchange for a finders fee and an overriding royalty interest in each lease that the debtor acquired in the prospect areas. The bankruptcy court did not discuss subsection 541(d), but merely indicated that section 544 speaks of property of the estate, and property that is held in trust is not property of the estate. The court found that a joint adventure relationship existed between GEC and the debtor which gave rise to a fiduciary duty on the part of the debtor with respect to GEC. The overriding royalty interests, therefore, were subject to a constructive trust and thus were not property of the estate that could be subject to section 544.

On similar facts, the court in *Boyd* also determined that a constructive trust could be imposed on unassigned oil and gas interests, but further stated that the existence of a constructive trust compels the application of subsection 541(d). However, the *Boyd* court did not reach the issue of whether subsection 541(d) acted to limit subsection 544(a)(3).

In *Partners Oil*, the court simply found that subsection 541(d) was applicable to the equitable interests of the unrecorded interest owners, whereas the court in *Mahan & Rowsey* relied on a constructive trust theory to exclude the unassigned interests from property of the estate. The concept that property held in trust does not become property of the estate was well established prior to the 1978 Amendments. However, in analyzing the interplay between subsections 541(d) and 544(a)(3), it is important to realize that equitable liens or constructive trusts, under common law, are enforceable against judicial lien creditors but are not enforceable against bona fide purchasers. Thus, the cases decided under prior law upholding the imposition of constructive trusts against Trustees in bankruptcy should be decided differently under current law, if such cases involve real property, because the Trustee is now a bona fide purchaser.

This concept was illustrated in *C.R. Loup v. Great Plains Western Ranch Co. (In re Great Plains Western Ranch Co.)*. In *Great Plains*, the debtor held record title to a Texas ranch and a Mississippi farm. The

44. *Id.* at 531-32.
46. *Id.* at 781.
claimants, L & M and Wilson County, asserted beneficial interests in the properties. L & M and Wilson County further asserted rights to assignments of record title to the properties by virtue of a constructive trust arising as a result of fraud committed by the record title holder. For purposes of its analysis, the bankruptcy court assumed that the record title holders did in fact defraud the plaintiffs. The court agreed that given the existence of fraud, a constructive trust could be imposed.\textsuperscript{50} The court further agreed that because the property was the subject of a trust, it would not become property of the estate under subsection 541(d).\textsuperscript{51} However, the court found that under subsection 544(a)(3), the Trustee can bring property into the estate if the Trustee can establish his status as a bona fide purchaser under state law.\textsuperscript{52} Thus, the court’s holding indicates that subsection 541(d) does not act as a limitation on subsection 544(a)(3). Relying “primarily” on the analysis in \textit{Great Plains}, the court in \textit{Cascade Oil}\textsuperscript{53} found that unrecorded assignments of oil and gas leasehold interests could be avoided under subsection 544(a)(3), notwithstanding subsection 541(d).\textsuperscript{54}

In \textit{Elin v. Busche (In re Elin)},\textsuperscript{55} the court also concluded that subsection 541(d) does not act as a limitation on subsection 544(a)(3). The court observed that section 551 preserves transfers avoided under section 544 for the benefit of the estate, and that subsection 541(a)(4) brings into the debtor’s estate property preserved under section 551. Thus, the court concluded that the interplay between sections 541, 544, and 551 enable the Trustee to assert his bona fide purchaser status to bring into the estate property that might otherwise be excluded from the estate under the provisions of subsection 541(d).\textsuperscript{56}

The \textit{Great Plains} and \textit{Elin} analyses appear to allow the Trustee to avoid unrecorded or unassigned interests whether they are asserted under a constructive trust theory or under the “industry practice” theory of \textit{Partners Oil}.\textsuperscript{57} However, if the \textit{Great Plains} and \textit{Elin} analyses are ap-
plied consistently, the Trustee could avoid equitable interests arising in the secondary mortgage market industry and subsection 541(d) would be written out of the Bankruptcy Code. Clearly, subsection 541(d) is intended to limit section 544. However, subsection 541(d) is inherently at conflict with subsection 544(a)(3), and one of the two sections must be limited. Unless Congress acts to clarify the conflict between these two sections, courts may choose the course followed by Investment Sales Diversified and limit subsection 541(d) to certain types of secondary mortgage market sales.

III. EXECUTORY CONTRACT ANALYSIS

A. General

The Trustee’s power to reject executory contracts is derived from the Trustee’s long recognized power to abandon burdensome property. Current law on the rejection of executory contracts is contained in section 365. Subsection 365(a) provides that “[t]he Trustee, subject to the law where certain types of oil and gas participation arrangements have been found to constitute joint ventures. McLaughlin v. Lafoon Oil Co., 446 P.2d 603, 609-10 (Okla. 1968). Joint ventures create a fiduciary relationship. Oklahoma Co. v. O’Neil, 440 P.2d 978, 985 (Okla. 1968). A constructive trust can be imposed if there is a breach of a fiduciary relationship. Rees v. Briscoe, 315 P.2d 758, 762-63 (Okla. 1957). For several reasons, however, attempts to assert the constructive trust theory could be more difficult than asserting the Partners Oil “industry practice” theory. First, as noted above, under state law a constructive trust will prevail over a judicial lien creditor, but will not prevail over a bona fide purchaser. See Robertson, 654 P.2d at 606; J.F. Case Threshing, 39 Okla. at 753, 136 P. at 772; see also Turner v. Emmons & Wilson, Inc. (In re Minton Group, Inc.), 28 Bankr. 774, 788 (Bankr. S.D.N.Y. 1983). Second, in Oklahoma there appears to be a requirement of active wrongdoing on the part of the person against whom recovery is sought. Easterling v. Farris, 651 P.2d 677, 680-81 (Okla. 1982); Cacy v. Cacy, 619 P.2d 200, 202 (Okla. 1980). In addition, a mere preponderance of the evidence is not sufficient to establish a constructive trust. Instead, it must be established by evidence which is clear, definite, and unequivocal, or which leaves no reasonable doubt as to the existence of the trust. Easterling, 651 P.2d at 681; Luton v. Martin, 337 P.2d 442, 445 (Okla. 1959). Finally, trust funds must be “traced” to the specific property on which the constructive trust is sought to be imposed. Turley v. Mahan & Rowsey, Inc., 62 Bankr. 46, 47 (W.D. Okla. 1985); Bistate Oil Co., Inc. v. Heston Oil Co. (In re Heston Oil Co.), 63 Bankr. 711, 714-16 (Bankr. N.D. Okla. 1985); Henderson v. Allred (In re Western World Funding), 54 Bankr. 470, 475 (Bankr. D. Nev. 1985).

58. The 1984 Amendments do not clarify the ambiguity. The reference in 11 U.S.C. § 541(d) to “subsection (a) of this section” has been limited to “subsection (a)(1) or (2).” One commentator has remarked that “[b]y excluding section 541(a)(3), which refers to property recovered under the avoiding powers, the amendment appears to make clear that section 541 is no bar to avoidance of equitable interests held by third parties if the avoiding powers so permit.” Andrew, Real Property Transactions and the 1984 Bankruptcy Code Amendments, 20 REAL PROP. PROB. & TR. J. 47, 68-69 (1985). Although the amendment gives technical strength to the Great Plains and Elin analyses, the amendment does not resolve the conflict between §§ 541(d) and 544(a)(3).

59. See legislative history, supra note 30.

60. See supra notes 33-34 and accompanying text.

61. 2 COLLIER, supra note 11, at ¶ 365.01, at 356-58; 4A id. at ¶ 70.43.1, at 516-17 (14th ed. Supp. 1980).
court's approval, may assume or reject any executory contract . . . of the debtor.”

In Chapter 7 liquidation proceedings, the Trustee must make his determination of whether to assume or reject an executory contract within sixty days after the order for relief, or the contract is deemed rejected. In Chapter 11 reorganizations, the Trustee generally has until confirmation of a Plan to determine whether to assume or reject an executory contract. If the Trustee elects to assume the contract and obtains a court order approving the assumption, the non-debtor contracting party will be protected because in order to assume the contract, the Trustee must cure all defaults under the contract, provide compensation for losses resulting from any defaults, and provide adequate assurance that the debtor will be able to continue to perform under the contract. If the Trustee satisfies the requisites for assumption, but subsequently breaches the assumed contract, the breach will be an expense of administration entitled to priority.

If the Trustee decides to reject the contract, however, the non-debtor contracting party could be left with only a general unsecured claim, providing little comfort to the entity seeking an assignment of a valuable oil and gas interest. Moreover, as the discussion below will demonstrate, both the judicially developed definition of what constitutes an executory contract and the judicially developed requisites for rejecting executory contracts have created problems in the area of land sale con-

63. Id. § 365(d)(1).
64. Id. § 365(d)(2). During this period of time the non-debtor contracting party is left in limbo concerning its rights and obligations under the contract. See generally Bordewieck, The Post-Petition, Pre-Rejection, Pre-Assumption Status of an Executory Contract, 59 AM. BANKR. L.J. 197 (1985). However, the non-debtor contracting party is not without recourse. Under 11 U.S.C. § 365(d)(2) “the court, on the request of any party to such contract . . . , may order the trustee to determine within a specified period of time whether to assume or reject such contract . . . .” Usually, the Trustee will object to a motion for such an order, and will be allowed a “reasonable time” within which to assume or reject the executory contract. PMG Corp. v. Hogan (In re Gulfo Ind. Corp.), 520 F.2d 741, 743 (10th Cir. 1975). The test of “reasonableness” will prompt a detailed factual inquiry into the facts and circumstances of the particular case, the posture of the bankruptcy proceedings, and the interests of the parties to the contract. Theatre Holding Corp. v. Mauro, 681 F.2d 102, 105 (2d Cir. 1982); In re Beker Ind. Corp., 64 Bankr. 890, 897 (Bankr. S.D.N.Y. 1986); New England Carpet Co. v. Connecticut Gen. Life Ins. Co. (In re New England Carpet Co.), 18 Bankr. 514, 516 (Bankr. D. Vt. 1982); In re Midtown Skating Corp., 3 Bankr. 194, 198 (Bankr. S.D.N.Y. 1980). The 1984 Amendments introduced an exception to the general rule contained in § 365(d)(2). Under § 365(d)(4), if an unexpired lease of nonresidential real property under which the debtor is the lessee is not assumed or rejected within 60 days after the order for relief, the lease will be deemed rejected.
66. Id. § 365(g)(2)(A).
67. Id. §§ 365(g)(1), 502(g).
tracts. Although Congress attempted to provide a legislative solution, the new statutory provisions do not clearly apply to contracts to buy and sell oil and gas working interests in Oklahoma.

B. Defining an Executory Contract

The term “executory contract” is not defined in the Bankruptcy Code. According to the legislative history of section 365, executory contracts “generally include contracts on which performance remains due to some extent on both sides.” A frequently used definition of executory contract is that propounded by Professor Vern Countryman. Countryman states that an executory contract is one “under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other.”

However, the Court of Appeals for the Tenth Circuit has adopted a definition for executory contract that is slightly different from the Countryman definition. The Tenth Circuit definition was established in Workman v. Harrison and King v. Baer. In Workman, the contract was a joint venture for the development of a shopping center, under which the debtor was obligated to provide money and hold title to the property. Workman, the non-debtor party to the contract, was obligated to negotiate the land purchase, make the necessary arrangements for rezoning the property, supervise construction of the shopping center, and obtain tenants for the completed project. The monies to be advanced by the debtor were to be repaid, with ten percent interest, from the contemplated income of the project. After the debtor had been repaid with interest, Workman and the debtor were to share the profits of the development equally. After the land was purchased, the debtor became the subject of bankruptcy proceedings. Through the cooperative efforts of Workman and the debtor’s Trustee, the rezoning was accomplished and construc-

68. See infra notes 95-101 and accompanying text.
69. See infra notes 102-05 and accompanying text.
72. 282 F.2d 693 (10th Cir. 1960).
73. 482 F.2d 552 (10th Cir.), cert. denied, 414 U.S. 1068 (1973). Workman and King utilize a federal law definition for the term executory contract. While it seems appropriate to analyze the parties’ obligations under the contract by reference to state law, Butner v. United States, 440 U.S. 48, 55 (1979), the determination of whether such obligations create an executory contract should be one of federal law. Benevides v. Alexander (In re Alexander), 670 F.2d 885, 888 (9th Cir. 1982).
tion was about to begin. At this point, the Trustee notified Workman that the uncertainties facing the debtor's financial future would prevent the debtor from completing performance of the contract.

The Court of Appeals for the Tenth Circuit determined that this contract was "executory in nature, neither party having completely performed and the obligations of each remaining complex." 74 The court affirmed the trial court's decision to permit rejection because "the financial condition of [the debtor] was such as to make the project burdensome and risky." 75 As to Workman, the court stated that he would have a claim equal to "the value of his contract at the date the petition of bankruptcy was filed." 76

In King v. Baer, 77 the debtor contracted to sell a 1/64th interest in Canadian federal oil and gas exploration permits. The non-debtor contracting party, King, had paid $260,912.05 of the total $5,218,241.00 purchase price. When the Trustee sought to reject the contract, King argued that the 1/64th interest was a vested property interest, not an executory contract. The Tenth Circuit determined that under the Workman definition, the purchase contract was executory in nature and could therefore be rejected. King also argued that he was entitled to restitution of the purchase price paid under the contract. The Tenth Circuit again disagreed, leaving King with only a claim for breach of the contract. 78

Although Workman and King were decided prior to the 1978 Amendments, the definition of an executory contract established by these cases should continue to apply. 79 Furthermore, this definition appears to have a pervasive application to the typically complex and ongoing relationships existing in the oil and gas industry. Indeed, given the broad language of both the Countryman and Workman definitions, 80 it might be more enlightening to determine what type of relationship is not executory within the meaning of section 365.

Non-executory contracts include contracts that have terminated ac-

74. Workman, 282 F.2d at 699.
75. Id.
76. Id.
77. 482 F.2d at 552.
78. Id. at 557.
80. It is not clear that there is any practical difference between the Countryman definition, which requires that substantial obligations remain unperformed, and the Workman definition, which requires that "complex" obligations remain unperformed. In King, for example, King's remaining obligation was no more "complex" than to pay the balance of the purchase price. King, 482 F.2d at 554. But see In re Harms, 10 Bankr. at 821 (certain limited partnership agreements were non-executory under the Countryman definition, yet executory under the Workman definition).
according to their own terms.\textsuperscript{81} Also, if the debtor has breached the contract prior to filing bankruptcy, and the non-debtor contracting party has obtained a judgment on its breach of contract claim, the contract could be considered non-executory.\textsuperscript{82}

Both the Countryman and \textit{Workman} definitions indicate that a contract is not executory unless obligations remain due by both parties to the contract.\textsuperscript{83} Thus, courts have indicated that a contract is not executory where the non-bankrupt party has fully rendered his performance, even though the bankrupt has performed only partially or not at all.\textsuperscript{84} In \textit{In re Biron, Inc.},\textsuperscript{85} the debtor had contracted to sell certain oil and gas leasehold interests. Although the debtor did not own all of the interests it had contracted to sell, it nonetheless conveyed the interests it did own to the non-debtor contracting party. The debtor then became the subject of bankruptcy proceedings and sought to reject the contract on the basis that it had not yet fully performed. The bankruptcy court determined that the contract was not executory because there was no possibility of further performance, the debtor having conveyed all the interests it could or ever would be able to convey.\textsuperscript{86}

\begin{thebibliography}{99}
\mn{81.} Trigg v. Andrus (\textit{In re Trigg}), 630 F.2d 1370, 1374 (10th Cir. 1980) (oil and gas leases that have expired for failure to pay delay rentals can no longer be assumed); see also Aetna Casualty & Surety Co. v. Gamel, 45 Bankr. 345, 349-50 (N.D. N.Y. 1984); \textit{In re Howard Indus., Inc.}, 56 Bankr. 5, 6 (Bankr. D.N.J. 1985); \textit{In re Crabb}, 48 Bankr. 165, 167-68 (Bankr. D. Mass. 1985).
\mn{82.} Chattanooga Memorial Park v. Still (\textit{In re Jolly}), 574 F.2d 349, 352 (6th Cir.) (although the court did not use the Countryman test, the result appears consistent with the result that would have been reached under the Countryman or \textit{Workman} definition), \textit{cert. denied}, 439 U.S. 929 (1978); see also \textit{In re Kendall Grove Joint Venture}, 46 Bankr. 531, 533 (Bankr. S.D. Fla. 1985), \textit{aff'd}, 59 Bankr. 407 (Bankr. S.D. Fla. 1986); \textit{In re Murthi}, 55 Bankr. 564, 568 (Bankr. N.D. Ill. 1985). Similarly, if the debtor's only obligation is to pay money, the contract is not executory. \textit{Elegant Concepts, Ltd. v. Kristiansen (In re Elegant Concepts, Ltd.)}, 61 Bankr. 723, 728 (Bankr. E.D.N.Y. 1986) (dictum).
\mn{83.} See NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522 n.6 (1984); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1045 (4th Cir. 1985), \textit{cert. denied}, 106 S. Ct. 1285 (1986). The requirement of actual performance due by both parties to the contract was determinative in \textit{In re KMMCO, Inc.}, 40 Bankr. 976 (Bankr. E.D. Mich. 1984). In this case, the debtor was obligated to pay certain sums of money to the non-debtor contracting party. This obligation terminated upon the occurrence of certain enumerated events which the court determined to be conditions subsequent. Because these conditions subsequent were not obligations, but simply events that would excuse performance by the debtor, the court determined that no unperformed obligations existed between the parties to the contract and thus the contract was not executory. \textit{Id.} at 978-79. \textit{But see Arrow Air v. Port Authority (In re Arrow Air, Inc.), 60 Bankr. 117, 122 (Bankr. S.D. Fla. 1986} (determination of whether a contract is executory should not depend on whether mutual obligations exist, but rather on whether assumption or rejection will ultimately benefit the estate and its creditors).
\mn{85.} 23 Bankr. 241 (Bankr. S.D. Ohio 1982).
\mn{86.} \textit{Id.} at 242.
\end{thebibliography}
In In re Soter, it the bankruptcy court determined that a contract is not executory unless "substantive obligations" of both parties remain unperformed. In Soter, the non-debtor vendor had performed everything required of it under a land sale contract including delivery of the deed to the escrow agent. The court determined that the contract was not executory because, other than the debtor-vendee's obligation to pay the balance of the purchase price, the only remaining obligation was the "ministerial" obligation of the escrow agent to deliver the deed to the debtor. Other cases, however, suggest that even where the only obligation existing under the purchase agreement is the "ministerial act" of delivering the deed, the contract is still executory.

If the purchaser of a working interest in an oil and gas lease has paid the purchase price for its interest, but not yet received its assignment, he or she could argue that the only act remaining is the "ministerial act" of making the assignment and that the purchase contract is therefore no longer executory. In purchasing a working interest in an oil and gas well, however, the purchaser may become obligated to pay its share of the continuing costs of the project. These costs could include drilling, completion, and operating costs, depending on what stage of the project the purchase occurs. In Sombrero Reef Club, Inc. v. Allman (In re Sombrero Reef Club, Inc.), purchasers of timeshare interests in a resort-marina paid an initial purchase price, together with annual dues, for the right to use the facilities for one week per year for thirty years. The court determined that even where the initial purchase price had been fully paid, the obligation to pay annual dues, together with the debtor's obligation to

88. Id. at 843; see also Hatoff v. Lemons & Assocs. (In re Lemons & Assocs.), 67 Bankr. 198, 216 (Bankr. D. Nev. 1986) (where purchasers of interests in mortgages sold in secondary mortgage market have paid the amount due, the debtor's unilateral obligation to convey title is insufficient to render agreement executory); In re Fahnders, 66 Bankr. 94, 96 (Bankr. C.D. Ill. 1986) (contract for sale of real estate not executory where deed has been placed in escrow prior to commencement of the case).
89. Benevides v. Alexander (In re Alexander), 670 F.2d 885, 887 (9th Cir. 1982) (contract for sale of land is executory where non-debtor vendee had deposited in escrow the funds necessary to close, but debtor refused to convey title or surrender possession); Hall v. Perry (In re Cochise College Park, Inc.), 703 F.2d 1339, 1349 n.5 (9th Cir. 1983) (where the debtor-vendor's only remaining obligation under certain land sale contracts was to deliver a warranty deed upon completion of payments by the non-debtor vendees, the contracts would nonetheless still be executory); Hunts Point Tomato Co. v. Roman Crest Fruit, Inc. (In re Roman Crest Fruit Inc.), 35 Bankr. 939, 948 (Bankr. S.D.N.Y. 1983) (even though "[a]ll that remained for the debtor to do at closing, upon securing [a] written consent [from a government authority] and receiving the purchase price, was to satisfy its warranty and representation of no liens and encumbrances and to turn over possession of the property to the plaintiff," the contract was executory).
90. 18 Bankr. 612 (Bankr. S.D. Fla. 1982).
maintain and operate the facilities, rendered the timeshare purchase contracts executory.\textsuperscript{91} Similarly, the working interest purchaser's continuing obligation to pay well costs, together with the well operator-debtor's obligation to operate the well, could render many contracts to purchase working interests executory.\textsuperscript{92}

C. The Business Judgment Test

As discussed previously, the Trustee's power to reject executory contracts is derived from the Trustee's abandonment power. As a result, old authorities can be found for the proposition that an executory contract cannot be rejected if the Trustee does not prove that it is "burdensome." This meant so long as the estate earned a profit under the contract, the Trustee would not be able to reject the contract, even though rejection could allow the Trustee to pursue a greater profit under another contract.\textsuperscript{93} Under current law, however, if the debtor can obtain a better contract by rejecting the existing contract, it is appropriate for the Trustee to exercise his "business judgment" by rejecting the existing contract and pursuing the more profitable one.\textsuperscript{94}

\textsuperscript{91} Id. at 616-17.

\textsuperscript{92} If the working interest purchaser wished to maintain that the contract to purchase is not executory, the purchaser should consider arguing that the contract for purchase of the working interest and the agreement governing continuing operations are severable and not interdependent. \textit{See In re Gardiner, Inc.}, 50 Bankr. 491, 493-94 (Bankr. M.D. Fla. 1985) (brokerage agreements were severable from purchase and sale agreements; thus, assumption of purchase and sale agreements did not require debtor-in-possession to honor brokerage agreements as an element of its cure obligations); \textit{cf. Jensen v. Continental Fin. Corp.}, 591 F.2d 477, 482 (8th Cir. 1979) (security agreement executed in connection with pre-petition class action settlement was severable from settlement agreement; thus, rejection of settlement agreement did not result in rejection of security agreement).

The degree to which the contract for purchase of the leasehold interest is severable from the operating agreement can only be determined by an examination of the contracts involved. Potentially, there is a continuum of different relationships, ranging from two entirely separate contracts to a completely integrated contract that calls for the investment in the prospect by the "purchaser," with no real distinction made between the initial purchase price and the continuing drilling and completion costs. Also, if under the terms of the relationship in question, the purchaser is less a direct participant, and more an investor, he may run afoul of an entirely different problem. \textit{See In re Amarex, Inc.}, 53 Bankr. 888, 891 (Bankr. W.D. Okla. 1985) (drilling program limited partners who had filed a securities fraud suit against insiders, control persons, and underwriters found their claims against the debtor subordinated to the claims of unsecured creditors under the automatic provisions of § 510(b)). \textit{But cf. In re Rhine}, 241 F. Supp. 86, 91 (D. Colo. 1965) (under Pre-Code bankruptcy law, as applied to Colorado state law, a defrauded investor's right to rescind prevails over Trustee's status as judicial lien creditor).


D. The Perceived Problem

In cases decided prior to the 1978 Amendments, courts determined that contracts to buy and sell real property were executory contracts, and that the purchaser's equitable title could therefore be divested by the Trustee's statutory power to reject the contract.95 Further, under the business judgment test, the Trustee could presumably reject any land sale contract where the property subject to the contract could be sold to a third party at a price in excess of the unpaid portion of the purchase price under the contract.96

The Trustee's ability to divest a purchaser's equitable title together with the application of the business judgment test led to harsh and capricious consequences. In *Baffico v. England (In re Mercury Homes Development Co.)*,97 the Trustee sought to reject a contract to sell a single family condominium unit where the purchaser was in possession. The court, recognizing the harsh consequences of applying the existing authorities, refused to convert the purchaser "from the role of householder to the role of an unsecured creditor,"98 and allowed the purchaser the remedy of specific performance.99 The capriciousness of applying the old authorities may be illustrated by considering the fact that a vendee who has paid 90% of the purchase price would, under the old authorities, receive an unsecured claim and have lost the amounts paid, while the vendee who paid 100% of the purchase price would have received full performance because the contract was no longer executory. These problems led commentators100 and the Commission on the Bankruptcy

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96. See supra notes 93-94 and accompanying text. One commentator has suggested, however, that the older "burdensome" test may still be viable in land sale contract cases. 2 COLLIER, supra note 11, at ¶ 365.10, at 365-58. The business judgment test has been limited by a few recent cases which have indicated that rejection must benefit creditors, not just the debtor. Bregman v. Meehan (*In re Meehan*), 59 Bankr. 380, 385-86 (E.D.N.Y. 1986); accord Robertson v. Pierce (*In re Chi-Feng Huang*), 23 Bankr. 798, 803 (Bankr. 9th Cir. 1982) (dictum); cf. *Waldron*, 785 F.2d at 940-41 (financially secure debtor not allowed to file for bankruptcy protection where only purpose is to reject contract); Chinichian v. Campolongo (*In re Chinichian*), 784 F.2d 1440, 1445-46 (9th Cir. 1986) (the court need not consider whether rejection of contract under plan is appropriate where confirmation of plan itself is denied because plan was not filed in good faith).
97. 4 BANKR. CT. DEC. 837 (CCR) (Bankr. N.D. Cal. 1978).
98. Id. at 839.
99. Id. at 840.
Laws of the United States\textsuperscript{101} to suggest amendments to executory contract law.

E. The Legislative Solution

Included among the 1978 Amendments were provisions for special remedies, in the event of rejection, to purchasers under contracts for the sale of real property. Specifically, purchasers of real property who are in possession of the property are given what is essentially a remedy of specific performance.\textsuperscript{102} Purchasers not in possession are given the equivalent of a vendee's lien to secure that portion of the purchase price paid.\textsuperscript{103} Thus, by enacting remedies specifically tailored for purchasers of real property, Congress implicitly endorsed the business judgment test\textsuperscript{104} and directed the focus away from definitional niceties to an approach based upon common law protection of land sale contract vendees.\textsuperscript{105}


\textsuperscript{102} 11 U.S.C. § 365(i) (1978) provides in pertinent part:

\begin{enumerate}
\item If the trustee rejects an executory contract of the debtor for the sale of real property under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property.
\item If such purchaser remains in possession—
\begin{enumerate}
\item such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and
\item the trustee shall deliver title to such purchaser in accordance with the provision of such contract, but is relieved of all other obligations to perform under such contract.
\end{enumerate}
\end{enumerate}

\textit{Id.}, amended by Supp. II 1984 (see infra note 137 and accompanying text for the amended version of § 365(i)).

\textsuperscript{103} Subsection 365(j) provides:

A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid.


F. Application to Oil and Gas Leases in Oklahoma

In determining whether the foregoing legislative concern for vendees will extend to would-be Oklahoma oil and gas lease vendees, defining the terms “real property” and “in possession” will obviously be crucial. These issues have been analyzed with respect to oil and gas leases. In re J. H. Land & Cattle Co., the debtor-lessee sought to reject an oil and gas lease. The lessee had expended time, effort, and expense in preparing to develop the properties leased, but there had been no physical activity on any of the properties. The bankruptcy court approved the rejection of the lease as an executory contract or unexpired lease. The lessee then argued that he was in possession within the meaning of subsection 365(h)(1). However, the bankruptcy court determined that under Kansas law, an oil and gas lease does not create any vested estate in the nature of title to the land. Instead, the lease merely conveys a license to enter upon the land and explore for such minerals and if they are discovered, to produce and sever them. The court thus concluded that the lessee was not entitled to the protections of subsection 365(h)(1). The court clearly looked to state law in analyzing the issues, although it is somewhat unclear as to whether the decision was based on the court’s determination that the lessee had no right to possession or upon the determination that oil and gas leases are personal property.

Another approach to this issue is set forth in Summit Land Co. v. Allen (In re Summit Land Co.). The bankruptcy court determined that “construing ‘in possession’ according to the abstract, sometimes rarified, and frequently arcane precepts of state property law is . . . inappropriate” and that the legislative history of subsections 365(i) and (j) should be analyzed to develop a federal law definition for the term “in possession.” Judge Mabey examined legislative history and

106. In addition to the Trustee’s power to assume or reject executory contracts, the Trustee also has the power to assume or reject unexpired leases. See generally 11 U.S.C. § 365 (1978).
108. Id. at 239. For further discussion of whether an oil and gas lease is subject to § 365, see In re Heston Oil Co., No. 85-C-929-B, slip op. at 3-4 (N.D. Okla. Oct. 9, 1986) (rejects analysis of J.H. Land & Cattle and holds that oil and gas leases in Oklahoma are not subject to § 365); In re Gasoil, Inc., 59 Bankr. 804, 809 (Bankr. N.D. Ohio 1986) (oil and gas leases in Ohio are subject to § 365); In re Myklebust, 26 Bankr. 582, 584 (Bankr. W.D. Wis. 1983) (mineral lease of sand and gravel is subject to § 365); Note, Rejection of Unexpired Oil and Gas Leases in Bankruptcy Proceedings: In re J.H. Land & Cattle Co., 19 TULSA L.J. 68 (1983); see also 11 U.S.C. § 365(m) (1982 & Supp. III 1985).
109. J.H. Land & Cattle, 8 Bankr. at 239. Analogous to § 365(i), § 365(h) provides protection to the non-debtor lessee in possession of real property subject to an unexpired lease.
111. Id. at 317.
critical commentary and concluded that "the mention of residential buyers, consumers and the poor . . . suggests a concern for buyers whose connection with the land is in fee simple, not fractionated, and is more productive and long term than speculative and short term," and held that purchasers of recreational use permits were not "in possession" within the meaning of subsections 365(i) and (j). Utilizing the federal law approach suggested by Summit would result in a non-debtor farmee under an executory farmout agreement being deprived of the protections afforded by subsection 365(i). A farmee's oil and gas working interest is clearly fractionated and also somewhat speculative. Further, such an interest is "a base or qualified fee, i.e., an estate in real property having the nature of a fee, but not a fee simple absolute."

Even under the state law analysis suggested by J.H. Land & Cattle, a farmee might not be considered "in possession," despite the fact that drilling operations have been conducted. The lessee's interest in an Oklahoma oil and gas lease is generally considered to be an incorporeal or nonpossessor interest. Given the "abstract, rarefied and arcane" Oklahoma law classifications of oil and gas leasehold interests, however, a Trustee might successfully persuade the court to utilize the federal law analysis contained in Summit, focus on the speculative nature of the investment and the fractionated nature of the ownership, and obtain a determination that the farmee is not in possession within the meaning of subsection 365(i).

If the protections of subsection 365(i) are not available to working interest purchasers due to the "in possession" requirement, they will be forced to seek the protections of subsection 365(j). However, there is still the question of whether the term "real property" as used in subsection 365(j) includes oil and gas leases. In considering this question, the treat-
tment of oil and gas leases under state law regarding vendees' liens might be examined. Oklahoma law provides for both a vendor's lien for the unpaid portion of the purchase price under a contract for the sale of real property and a vendee's lien for the purchase price paid under a contract for the sale of real property.\textsuperscript{118} Both liens are valid against creditors of the debtor, except bona fide purchasers.\textsuperscript{119}

In \textit{Casper v. Neubert},\textsuperscript{120} the Court of Appeals for the Tenth Circuit held that the statutory vendor's lien under Oklahoma law was available to the seller of certain oil and gas leases. The decision is at variance with Oklahoma decisions that have treated oil and gas leases as falling within statutes phrased in terms of "interest in real property" or "conveyances affecting real property,"\textsuperscript{121} but not within statutes phrased in terms of "real property."\textsuperscript{122} The Tenth Circuit brushed aside this authority by citing a "clear statutory policy to protect vendors against the inequity of a vendee accepting conveyance of property and refusing to pay the purchase price."\textsuperscript{123} The court indicated that because oil and gas lease vendors could not avail themselves of the remedies afforded sellers under the Uniform Commercial Code,\textsuperscript{124} such vendors must be afforded the statutory vendor's lien to avoid a gap in protection.\textsuperscript{125}

However, sellers under the Uniform Commercial Code are not afforded a statutory lien, but only the limited right of reclamation.\textsuperscript{126} Moreover, the treatment of non-debtor vendors under bankruptcy law is quite different from the treatment of non-debtor vendees.\textsuperscript{127} Finally, the

\begin{footnotesize}
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  \item \textsuperscript{118} \textit{Okla. Stat. tit. 42, §§ 26, 30 (1981)}.
  \item \textsuperscript{119} \textit{Id.} at § 28.
  \item \textsuperscript{120} 489 F.2d 543 (10th Cir. 1973).
  \item \textsuperscript{121} \textit{Williams & Meyers, supra} note 3, at § 214.2, at 170.7; \textit{id.} cases cited n.3.
  \item \textsuperscript{122} First Nat'l Bank of Healdton v. Dunlap, 122 Okla. 288, 291, 254 P. 729, 732 (1927) (oil and gas lease is not "real estate" for purposes of the statute creating a judgment creditor's lien upon "real estate"); State v. Shamblin, 185 Okla. 126, 129, 90 F.2d 1053, 1055 (1939) ("Being personal property, such oil and gas mining leases in Oklahoma are not taxable as real property . . . ."); Duff v. Keaton, 33 Okla. 92, 102-03, 124 P. 291, 294-95 (1912) (oil and gas lease is not a conveyance or sale of real estate under probate code); \textit{accord Cate v. Archon Oil Co.}, 695 P. 2d 1352, 1354 n.1 (Okla. 1985) (dictum). The general classification of oil and gas leases as personal property is not, however, without exception. \textit{See}, e.g., Phillips Petroleum Co. v. Jones, 176 F.2d 737, 740-41 (10th Cir. 1949) (although Oklahoma law does not treat oil and gas leases as real property, the policy of applying federal taxes in a uniform manner requires that oil and gas leases be subject to federal documentary stamp tax on transfers of real property); \textit{supra} notes 23-28 and accompanying text (oil and gas leases are real property for purposes of § 544(a)(3)).
  \item \textsuperscript{123} \textit{Casper}, 489 F.2d at 546.
  \item \textsuperscript{124} \textit{Okla. Stat. tit. 12A, § 2-107 (1981)}.
  \item \textsuperscript{125} \textit{Casper}, 489 F.2d at 546.
  \item \textsuperscript{127} The protections of §§ 365 (i) and (j) are afforded only to non-debtor vendees. Also, where
\end{itemize}
\end{footnotesize}
policies underlying Oklahoma's vendor's lien statute clearly do not outweigh the policies protecting bona fide purchasers,\(^\text{128}\) and the Trustee has the status of a bona fide purchaser.\(^\text{129}\) Thus, the characterization of oil and gas leases as "interests in real property," and not "real property," is rejected by Casper on the basis of state law policies that are somewhat unclear and should be largely irrelevant in answering a question that is one of federal bankruptcy law.

An examination of bankruptcy decisions suggests a different approach. Cases decided under pre-Code law looked to the specific provisions of the contract to determine the vendee's remedies upon rejection.\(^\text{130}\) In a case decided under the Code, Burke Investors v. Nite Lite Inns (In re Nite Lite Inns),\(^\text{131}\) the protections of subsection 365(j) were denied to the buyer-lessee in a sale-leaseback transaction involving motel property. The bankruptcy court based its decision on an examination of the contract in question, finding a disguised financing device set up as a sale-leaseback for tax purposes. Because the buyer-lessee was only investing in the property and sought no "ownership interest," it was not entitled to the protections of subsection 365(j).\(^\text{132}\) Nite Lite thus suggests an inquiry into the specific nature of the rights to be purchased

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\(^{130}\) Gulf Petroleum, S.A. v. Collazo, 316 F.2d 257, 261 (1st Cir. 1963) (where the terms of escrow created fiduciary duty with respect to down payments received, the vendee was entitled to essentially a constructive trust); In re New York Investors Mutual Group, Inc., 143 F. Supp. 51, 53 (S.D.N.Y. 1956) (vendee's lien was enforceable where contract for sale provided for a lien securing the down payment and the lien was recorded).


\(^{132}\) Id. at 910; see also Hatoff v. Lemons & Assocs. (In re Lemons & Assocs.), 67 Bankr. 198, 215-16 (Bankr. D. Nev. 1986) (vendees of interests in mortgages sold in secondary mortgage market denied the protections of § 365(j) because the title sought was to be held for purposes of security, not ownership).
under the contract and draws a distinction between an interest in the profits to be derived from the property and ownership of the property itself.

A similar approach was utilized in Sombrero Reef Club, Inc. v. Allman (In re Sombrero Reef Club, Inc.).\(^{133}\) Having concluded that the contracts were executory,\(^{134}\) the bankruptcy court addressed the issue of whether the timeshare purchasers were entitled to the protections of subsection 365(i). As in Nite Lite, the court looked to the nature of the interest to be purchased by examining the specific terms of the contract. The court found that the purchasers were not buying any interest in the properties except the right to reserve and occupy accommodations. The court concluded that subsection 365(i) did not apply because “[s]ubsection (i) does not refer to an ‘interest’ in real property or an ‘estate’ in real property; it refers only to a ‘sale of real property’.”\(^{135}\) If a court were to adopt the Nite Lite and Sombrero analyses, it might look to the nature of the oil and gas working interest, determine that the parties are more concerned with the severed minerals than with the real property itself, and deny working interest purchasers the protections of subsection 365(j).

At least two commentators supported the Sombrero decision on the basis that it was consistent with the policy underlying the changes introduced in the 1978 Amendments.\(^{136}\) In the 1984 Amendments, however, Congress revised subsection 365(i) as follows:

\[\text{(i)(1) If the trustee rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under a timeshare plan, under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property or timeshare interest.}\] \(^{137}\)

Thus, Congress decided to reject the Sombrero result. In doing so, however, Congress did not opt to amend the statute by defining “real property” to include timeshare interests, nor did Congress opt to extend the protections of subsection 365(i) to purchasers of “interests in real prop-

\(^{133}\) 18 Bankr. 612, 618 (Bankr. S.D. Fla. 1982).
\(^{134}\) Id. at 616-17; see supra note 91 and accompanying text.
\(^{135}\) Sombrero, 18 Bankr. at 618.
\(^{136}\) Weintraub & Resnick, Rejection of Time-Share Purchaser Agreements in Bankruptcy—Let the Buyer Beware!, 17 U.C.C. L.J. 72, 75 (1984); Note, Treatment of Time-Share Interests Under the Bankruptcy Code, 59 Ind. L.J. 223, 243 (1984). The latter article, while concluding that timeshare purchasers should not be afforded the protections of § 365(i), nonetheless concludes that timeshare purchasers who receive title, unlike the purchasers in Sombrero, should be afforded the protections of § 365(j). Id. at 237.
portunity.” Instead, the terms “real property” and “timeshare interests” are used in the conjunctive, which suggests that Congress, while deciding that timeshare purchasers were deserving of protection, Nonetheless agreed with the Sombrero determination that timeshare interests are not “real property.”

The significant changes in executory contract law introduced by the 1978 Amendments and by the 1984 Amendments reflect a recognition by Congress of the undesirable results that occur when the broad definition of executory contracts and the business judgment test for rejection are applied to certain types of contracts. Congress elected to remedy these undesirable results, not by overruling the judicially developed definition or business judgment test, but rather by enacting specific exceptions applicable only to the types of contracts to which application of the general rules produced undesirable results. Oklahoma law does not generally treat oil and gas leases as falling within statutes phrased specifically in terms of “real property.” Thus, purchasers of oil and gas working interests may have a difficult time availing themselves of the protections afforded purchasers of real property, unless they can convince courts to apply the Casper analysis of state law vendor’s liens to the federal law vendee’s lien of subsection 365(j) or convince Congress to grant oil and gas working interests the same special treatment enjoyed by timeshare interests.

138. Specific definitions for the terms “timeshare interest” and “timeshare plan” were provided in 11 U.S.C. § 101(47) (1982).

139. Sombrero, 18 Bankr. at 618; see also Lemons, 67 Bankr. at 215-16 (the protections added for timeshare interests provide “no justification for expanding the scope of § 365(j) to include all interests somehow related to real property”). While Congress may have impliedly answered the question of whether timeshare interests are real property, the amendments do not answer the question, posed in Summit, 13 Bankr. at 311, of whether or when purchasers of timeshare interests would be considered in possession. Also, under the current structure of the statute, a timeshare interest purchaser not in possession will not be entitled to a lien under 11 U.S.C. § 365(j) (1982). See Andrew, supra note 58, at 57-60. Finally, more ambiguity is created by § 365(m), also introduced by the 1984 Amendments, which provides that “[f]or purposes of this section 365 and sections 541(b)(2) and 362(b)(9), leases of real property shall include any rental agreement to use real property.” 11 U.S.C. § 365(m) (Supp. II 1984). Although this provision has been cited as support for the conclusion that oil and gas leases are subject to assumption or rejection under § 365(a), see In re Gasoil, Inc., 59 Bankr. 804, 806 (Bankr. N.D. Ohio 1986), the provision would not appear to require that sales of oil and gas leases be treated as sales of real property. For a discussion of other issues raised by the 1984 Amendments, see Solomon, Real Estate Aspects of the 1984 Amendments to the Bankruptcy Code, 90 COM. L.J. 288, 291-93 (1985).

140. The types of contracts afforded special treatment include commodity contracts, 11 U.S.C. §§ 365(a), 765, 766; shopping center leases, id. § 365(b)(3); collective bargaining agreements, id. § 1113; and, of course, leases of real property and contracts to buy real property or timeshare interests, id. § 365(i).

141. See supra note 122 and accompanying text; see also Note, supra note 108, at 97 (concluding that Oklahoma leasehold interests will be treated as personal property, and therefore not entitled to the protection of 11 U.S.C. § 365(h) (1982 & Supp. II 1984).

142. See supra notes 120-29 and accompanying text.
interests and other special contracts.\textsuperscript{143}

\section*{IV. Conclusion}

In promulgating laws of bankruptcy, Congress cannot answer all questions for all industries and, indeed, should probably not attempt to do so. Congress has attempted, however, to protect certain industries from the Trustee's power to avoid unrecorded interests and reject executory contracts. In its attempts to provide this protection, Congress has increased the difficulty of applying federal bankruptcy law to the vagaries of state law defined oil and gas property rights.

\textsuperscript{143} Assuming working interest purchasers can obtain the protections of § 365(j), the amount to include in the "purchase price paid" must be determined. The purchaser will argue that purchase price should include all joint interest costs paid. In Seawane Greens, Inc. v. Bailey, 181 N.Y.S.2d 269, 271 (N.Y. App. Div. 1958), however, the vendee's lien was limited to the monies paid under the purchase contract, and not extended to the cost of improvements made by vendee. Furthermore, if Congress had meant the 11 U.S.C. § 365(j) (1982) lien to extend to improvements, it could have so provided, as it did for voided transfers under 11 U.S.C. § 550(d) (1982 & Supp. II 1984). Finally, once the validity of and amount of the § 365(j) lien is established, priority disputes may arise with oil and gas well mortgages, lien claimants, or even other § 365(j) lien claimants. Seidle v. Milgram (In re 18th Ave. Dev. Corp.), 10 Bankr. 107, 109 (Bankr. S.D. Fla. 1981) (competing 11 U.S.C. § 365(j) liens treated pari passu). Even without a § 365(j) lien, to the extent the working interest purchaser has paid its proportionate share of well costs attributable to the interests now retained by the Trustee, such purchaser could argue that these payments represent overpayments held in trust by the debtor. See Turley v. Mahan & Rowsey, Inc. (In re Mahan & Rowsey, Inc.), 35 Bankr. 898, 903 (Bankr. W.D. Okla. 1983) (constructive trust imposed for overpayments of well costs by non-operating working interest owner), rev'd on other grounds, 62 Bankr. 46 (W.D. Okla. 1985). Finally, although the working interest purchaser has lost his equitable right to specific performance of the assignment, he may be entitled to an unsecured claim under 11 U.S.C. 365(g) (1982). Lubrizol Enters., Inc. v. Richmond Metal Finishers, 756 F.2d 1043, 1048 (4th Cir. 1985), \textit{cert. denied}, 106 S. Ct. 1285 (1986); \textit{In re Aslan}, 65 Bankr. 826, 829-831 (Bankr. C.D. Cal. 1986).