

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	CHAPTER 11
BARROW SHAVER RESOURCES	§	
COMPANY LLC	§	CASE NO. 24-33353
<i>Debtor.</i>	§	

PETITIONING CREDITORS' SUPPLEMENTAL OBJECTION TO
DEBTOR'S PAYMENTS OF MINERAL INTERESTS
[Related to Dkt. No. 61]

COME NOW, Axis Energy Services, LLC, DOC Energy Services, LLC, Cudd Pressure Control, Inc., Thru Tubing Solutions, Inc., Genesis Fluids, LLC, and Force Pressure Control, LLC, (collectively the "**Petitioning Creditors**"), and file this Objection (the "**Objection**") to the Debtor's *Emergency Motion for Entry of Final [or Continuance of Interim] Order (I) Authorizing the Debtor to Pay or Apply Payments Attributable to Mineral Interests in the Ordinary Course and (II) Granting Related Relief* [Dkt. No. 61] (the "**Mineral Interests Motion**"), and in support of the Objection respectfully submits as follows:

SUMMARY OF OBJECTION

The Petitioning Creditors requests that this Court deny the Mineral Interests Motion. The Mineral Interest Motion seeks to improperly pay invalid interest, permit the circumvention of liens, and violate the Absolute Priority Rule. From the Debtor's own pleadings, many interests sought to be paid under the Mineral Interest Motion would fail to satisfy the statute of frauds; the identity of these invalid interest holders have yet to be identified, and no information is known regarding the interest amounts, the amounts paid, or the amounts intended to be paid. To protect the Estate and the Petitioning Creditors' lien rights, the Petitioning Creditors must request that this Court sustain this Objection.

I. FACTUAL BACKGROUND

1. On July 23, 2024 (the “**Involuntary Petition Date**”), Axis Energy Services, LLC, DOC Energy Services, Inc., Cudd Pressure Control, Inc., Thru Tubing Solutions, Inc., Genesis Fluids, LLC, and Force Pressure Control, LLC (collectively, the “Petitioning Creditors”) filed an involuntary petition under Chapter 7 of the Bankruptcy Code after months of the Debtor not paying their debts as they became due. Upon information and belief, the Debtor owes an estimated \$67 million in outstanding trade debt with \$40 million of the \$67 million being perfected by mineral liens. Of that \$67 million, the Debtor owes over \$8 million to the Petitioning Creditors.

2. On August 19, 2024 (the “**Voluntary Petition Date**”), the Debtor filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Debtor continues to operate its business using the trade vendors as its financing structure rather than using a financial institution.

3. The Debtor revealed that it had purported to convey a number of ORRIs and Working Interests without properly documenting and/or recording the conveyances. Dkt. 61, Mineral Interest Motion at ¶ 24. Further, the Debtor states that many of the “Mineral Interests would likely fail to satisfy the statute of frauds.” Dkt. 61, Mineral Interest Motion at ¶ 40. Nevertheless, the Debtor seeks authorization to continue payments on these invalid interests for fears that it would be subject to litigation. Dkt. 61, Mineral Interest Motion at ¶ 42.

4. Under these verbal agreements, it is possible the Debtor was making up to “\$5,155,448 transfers per month” to alleged working interest owners (¶ 29) and an additional “\$519,317 per month” to ORRI Holders (as defined in the Mineral Interest Motion) (¶ 28). Dkt. 61, Mineral Interest Motion at ¶ 29, 28. The Petitioning Creditors file this Objection to halt the payments to these undocumented and unrecorded interests.

II. OBJECTION

5. As stated in Petitioning Creditors' Limited Objection (Dkt. No. 82), the Petitioning Creditors support the entry of an order authorizing the Debtor to pay, in the ordinary course of business and in the Debtor's discretion and business judgment, any payment attributable to a Royalty Interest, whether such amount accrued before or after the Involuntary Petition date or during the Gap Period. The Petitioning Creditors do not object to the payment of these amounts. The relief requested in the Payments of Mineral Interests Motion, however, also requests authority to pay ORRI and Working Interests.

6. The Petitioning Creditors support the entry of an order authorizing the Debtor to pay, in the ordinary course of business and in the Debtor's discretion and business judgment, any payment attributable to a ORRI or Working Interest that is not subject to Mineral Interest Title Issue. The Petitioning Creditors do not object to the payment of these amounts.

7. The Petitioning Creditors object to the entry of a final order authorizing the Debtor to pay any ORRI or Working Interest which may be subject to the Mineral Interest Title Issue and/or was either (i) not properly documented and/or (ii) not properly recorded. This Objection refers to any ORRI or Working Interest which is subject to the Mineral Interest Title Issue as a "**Purported Interest**" and a holder of a Purported Interest as a "**Purported Holder**."

A. Any Purported Interest Failing to Satisfy the Statute of Frauds Is an Unsecured Claim that Should Not Be Paid until Plan Confirmation.

8. The Debtor's own Investigation indicates that a "**a substantial majority of the conveyances supporting the Mineral Interests would likely fail to satisfy the statute of frauds.**" Dkt. 61 at ¶ 40. As the Debtor points out, "[u]nder Texas law, a conveyance of a working interest in oil and gas is a real property interest that subjects the agreement conveying the interest to the statute of frauds." *Exxon Corp. v. Breezvale Ltd.*, 82 S.W.3d 429, 436 (Tex. App.—Dallas

2002, pet. denied). A failure to satisfy the statute of frauds renders a purported agreement unenforceable. *See, e.g., Mitchell v. Mitchell*, No. 03-17-00318-CV, 2018 Tex. App. LEXIS 1332, at *20-21 (Tex. App.—Austin Feb. 16, 2018, pet. denied); Tex. Prop. Code § 13.001. The Debtor’s request to pay Purported Interests violates the maxim that “equity will not impart validity to an instrument which is void at law.” *Id.* at 550.

9. “Before using equity to circumvent the statute of frauds, the Texas Supreme Court has consistently required a showing that fraud would result in not doing so.” *Birenbaum v. Option Care*, 971 S.W.2d 497, 503 (5th Cir. 1997). Neither the Debtor nor any Purported Holder has claimed fraud would result from not enforcing an Interest that fails to satisfy the statute of frauds. Thus, any Purported Interest that fails to satisfy the statute of frauds is invalid, and the Court should sustain this Objection and refuse to permit payments towards these invalid Purported Interests.

B. Any Purported Interest that Satisfies the Statute of Frauds but was Unrecorded Is an Unsecured Claim that Should Not Be Paid until Plan Confirmation.

10. Even assuming that some of the Purported Interests do satisfy the statute of frauds and are valid, the Debtor’s Investigation also shows that many Purported Interests are unrecorded. Dkt. 61, Mineral Interest Motion at ¶¶ 4, 24. Any Purported Holder of a valid, unrecorded Purported Interest is likely an unsecured creditor. *See In re Jones*, 77 B.R. 541, 551 (Bankr. N.D. Tex. Sept. 8, 1987) (“The position of one who holds an unrecorded assignment is analogous to that of a ‘secured’ party who did not perfect his security interest. . . . Each must now file a claim and establish the damages which he suffered by virtue of his dealings with the Debtor.”).

11. Because the Debtor is not able to identify which Purported Interests are properly recorded, the Court should refuse to authorize the Debtor to make any payments on Purported Interests. Sustaining this Objection does not deprive Purported Holders of a remedy. The Purported Holders may file a proof of claim and participate in these proceedings. This Court should not, however, authorize payments to Purported Holders for unestablished property interests, for

unknown amounts, when the Debtor has failed to show any Code section or equitable argument in favor of granting this authority.

C. The Payments of Mineral Interests Motion Fails to Consider Priority.

12. The Debtor’s attempt to pay either invalid Purported Interests that do not satisfy the statute of frauds or valid but unsecured Purported Interests violates the Petitioning Creditors’ priority rights. “As soon as a debtor files a petition for relief, fair and equitable settlement of creditors’ claims becomes a goal of the proceedings.” *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984). “The words ‘fair and equitable’ are terms of art – they mean that ‘senior interests are entitled to full priority over junior ones.’” *Id.*

13. To be fair and equitable, the Absolute Priority Rule must be satisfied, which places secured creditors’ rights first, those of unsecured next, and subordinates the interests of stockholders. *In re Lakeside Global II, Ltd.*, 116 B.R. 499, 511 (Bankr. S.D. Tex. 1989). Ultimately, “no Chapter 11 reorganization plan can be confirmed over the creditors’ legitimate objections . . . if it fails to comply with the absolute priority rule.” *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988). The Mineral Interests Motion entirely ignores how payments to unsecured Purported Holders through an emergency motion will impact the Petitioning Creditors’ rights as secured creditors or the ability of this Court to confirm a final reorganization plan.

14. The Debtor requests relief based on, *inter alia*, Section 105(a), which allows the Court to issue any order necessary to carry out the provisions of Title 11. Section 105(a) creates discretion to “implement rather than override” the Code’s rules about priority and distribution. *In re Pioneer Health Servs.*, 570 B.R. 228, 234-35 (Bankr. S.D. Miss. Apr. 4, 2017). Section 105(a) is not “a roving commission to do equity.” *In re Oxford Management*, 4 F.3d 1329, 1334 (5th Cir. 1993).

15. The Petitioning Creditors' secured claims should be paid before any unsecured claims, in accordance with the Absolute Priority Rule. The 5th Circuit has come "perilously close" to holding that "the payment of prepetition unsecured claims prior to plan confirmation is not authorized under the Code." *In re CEI Roofing, Inc.*, 315 B.R. 50, 56 (Bankr. N.D. Tex. 2004). Since Purported Interests that satisfy the statute of frauds but were unrecorded are unsecured claims, the Purported Holders should be subordinated to the Petitioning Creditors. Such a structure is both in accordance with Fifth Circuit precedent and acknowledges that the Mineral Interest Title Issue was wholly avoidable by the Purported Holders.

16. To become secured, the Purported Holders needed only to record their interests, not hide their interests in the ether of unrecorded real property transactions. "“Whenever one entering into a business transaction fails to take the proper steps to protect his interest—whether that failure is caused by ignorance, neglect or the failure to seek proper advice—that person must bear the result of his failure.” *In re Jones*, 77 B.R. at 550-51. According to *In re Jones*, Texas courts have long held that, “where a creditor secures a lien against a person who has both possession and record title, the holders of unrecorded interests in the property are cut off.” *Id.* at 547-48 (citing *Triangle Supply Co. v. Fletcher*, 408 S.W.2d 765 (Tex. App.—Eastland 1966, writ ref’d n.r.e.)).

17. Since the unrecorded interests are cut off, these unsecured interests should not be paid prior to the Petitioning Creditors' secured interests. The Debtor's requests in its Mineral Interests Motion violates the Absolute Priority Rule and will hinder plan confirmation. The Petitioning Creditors request this Court sustain this Objection and deny the Debtor's Mineral Interests Motion to pay the Purported Interests.

D. Paying Purported Interests Pursuant to an Emergency Motion Further Complicates the Mineral Interest Title Issue.

18. The Debtor's request to pay Purported Holders the value of their ineffective or unsecured interests is premature. As the Debtor points out, paying the Purported Holders will not solve the Mineral

Interest Title Issue. Dkt. 61, Mineral Interests Motion at ¶ 32. Rather, paying the Purported Holders at this juncture further complicates the Mineral Interest Title Issue.

1. The Petitioning Creditors' Liens Would Have Trapped Prepetition Funds, Making Any Payments to Purported Interests on a Prepetition Basis Improper.

19. The Petitioning Creditors hold mineral liens under Chapter 56 of the Texas Property Code against certain of the Debtor's property. Notice of ownership of property becomes especially important for issues such as mineral liens, where several statutory provisions rely on proper notice to property owners. *See, e.g.*, Tex. Prop. Code § 56.021(b), 56.003, 56.023. Where the property owner has failed to record, and where the lien-holder is unable to alert the property owner because it does not know of the owner's existence, the lien-holder should not bear responsibility. *In re Jones*, 77 B.R. at 550-51.

20. The Mineral Interests Motion seeks to pay invalid and/or unrecorded Purported Interests prior to paying the Petitioning Creditors' secured claims and plan confirmation. To the extent that any Purported Interest is valid and unrecorded, the Petitioning Creditors' assert that their Liens have trapped any funds owed to the Debtor. Tex. Prop. Code § 56.043; *See In re Mid-America Petroleum, Inc.*, 83 B.R. 933, 935 (Bankr. N.D. Tex. Mar. 1, 1988). Yet the Mineral Interests Motion omits consideration of the disbursement of any funds trapped by the Petitioning Creditors' Liens.

21. In some cases, trapped funds are not property of the Estate. *In re T.S.C. Seiber Servs., L.C.*, 771 F.3d 246, 252 (5th Cir. 2014). If prepetition funds are not Estate property, they belong to the related creditors. *Id.* at 253 (citing *Green v. H.E. Butt Foundation*, 217 F.2d 553, 554-55 (5th Cir. 1954)). If the trapped funds are Estate property, "It is clear that, at minimum, lien-holding subcontractors have preference over other estate creditors." *Id.* (citing Tex. Prop. Code § 53.121 (granting preference for mechanic's liens); Tex. Prop. Code § 56.041 (authorizing enforcement in the same manner as Chapter 53); *Perry v. Wood*, 63 F.2d 257, 257 (5th Cir. 1933)).

22. The issue is further complicated by the creation of double liability for owners that improperly released trapped funds. In Texas, if an owner of an interest releases funds that should have been withheld, that owner would still retain liability to the lien claimant. *Mesa Southern CWS Acquisition, LP v. Deep Energy Exploration Partners, LLC*, No. 14-18-00708-CV, 2019 Tex. App. LEXIS 10107, at *8 (Tex. App.—Houston [14th Dist.] Nov. 21, 2019, no pet.).

23. Additionally, the Mineral Interests Motion fails to consider that the Petitioning Creditors should have been entitled to trap funds in the hands of Purported Holders. Tex. Prop. Code § 56.043. Because an unknown number of Purported Holders failed to record their Interests, the Petitioning Creditors were unable to trap funds in the hands of these Holders. See *In re Mid-America Petroleum, Inc.*, 83 B.R. 933 (Bankr. N.D. Tex. 1988).

24. The Debtor and the Purported Holders seek to circumvent the Purported Holders' failure to record—and potential double liability—by seeking payment on potentially invalid and unsecured Interests. This Court should direct the Debtor to refrain from disbursing funds to Purported Holders.

2. The Debtor Failed to Show ‘Immediate and Irreparable’ Harm Necessary to Grant the Authority to Make Post-Petition Payments to Purported Holders.

25. The Debtor claims the Court should grant the Debtor's emergency motion because not paying Purported Holders may cause them “to immediately resort to litigation based on an understanding that the Debtor lacks authority to make payments attributable to the [Purported] Interests.” Dkt. 61, Mineral Interests Motion at ¶ 48.

26. The Payments of Mineral Interests Motion cites but omits that *In re CoServ, L.L.C* considers the payment of prepetition debt in the context of so-called “critical vendors.” *In re CoServ, L.L.C.*, 273 B.R. at 491. The Debtor also cites *In re CoServ, L.L.C.* for the proposition that this Court may authorize payment of prepetition claims in appropriate circumstances, but ignores that case's essential holding that courts typically allow the payment of prepetition debt, other than pursuant to a plan, “only under extraordinary circumstances.” *In re CoServ, L.L.C.*, 273 B.R. 487,

491 (Bankr. N.D. Tex. Jan. 4, 2002); Dkt. 61 at ¶ 43. The Court should not grant such broad discretion to pay unsecured claims when the Debtor has made no showing of extraordinary circumstances.

27. Should the Debtor claim payments to Purported Holders constitute critical vendor payments, the extraordinary circumstances the debtor must show are that: (1) it must be critical that the debtor deal with the claimant; (2) unless it deals with the claimant, the debtor risks the probability of harm, or, alternatively, loss of economic advantage to the estate or the debtor's going concern value; and (3) there is no practical or legal alternative by which the debtor can deal with the claimant other than by payment of the claim. *In re CoServ, L.L.C.*, 273 B.R. 487, 498 (Bankr. N.D. Tex. Jan. 4, 2002).

28. The Debtor has not, and likely cannot, show that Purported Holders are critical to the Debtor's reorganization. According to the Debtor's Mineral Interest Motion, these interests may not be in writing; there may not be any contractual rights from either party.

29. The Payments of Mineral Interests Motion frets over the expenses of litigation related to the Mineral Interest Title Issue but ignores that validating unrecorded interests "open[s] a Pandora's Box of never-ending litigation." *In re Jones*, 77 B.R. at 550. The Debtor's claim that failing to pay Purported Interests *could* cause Purported Holders to attempt to terminate underlying leases or *could* cause higher administrative expenses lacks sufficient certainty to establish that it is critical for the Debtor to deal with the Purported Holders. The Debtor does not even explain how the nonpayment of ORRIs subject to the Mineral Interest Title Issue will immediately and irreparably harm the Debtor, given that ORRIs are non-cost bearing interests. Dkt. 61, Mineral Interests Motion at ¶ 3.

30. Overall, the Debtor lacks sufficient information to justify granting it the authority to pay any Purported Interests on a post-petition basis. The Debtor has not produced any evidence showing valid Working Interests or ORRIs. The Debtor has only claimed that failing to pay Purported Interests at this time might result in additional litigation for the Debtor.

31. The Petitioning Creditors are not at fault for the Debtor's bankruptcy, yet the Debtor seeks to usurp the Absolute Priority Rule by paying pre-petition, unsecured claims before the Petitioning Creditors' secured claims. The Debtor highlights liquidity concerns regarding added litigation and cites this litigation as the only justification for "necessary to allow the Debtor to pay certain of the Mineral Interest Holders." Dkt. 42 at ¶ 42. However, the Debtor also states that it will "resolve such issues consensually but, if necessary, through litigation." Dkt. 42 at ¶ 32.

32. The Debtor both states the need to *avoid* litigation but also the willingness and ability to prevail *through* litigation. If the Debtor is prepared to litigate, then the avoidance of litigation cannot satisfy the third prong of *In re CoServ, L.L.C.* that there is "no practical or legal alternative by which the debtor can with the claimant." *In re CoServ, L.L.C.*, 273 B.R. at 498.

33. In fact, section 544(b)(1) of the Bankruptcy Code provides a legal alternative. Section 544(b)(1) allows the Debtor to avoid the transfer of property that is voidable under Texas's statute of frauds. *See* 11 U.S.C. 544(b)(1).

34. The Debtor and its counsel feel as if they are "drinking from a firehose," but the solution to the overwhelming problems with the Debtor's financial condition is not to give the Debtor more authority to pay unknown holders indiscriminate amounts of money in satisfaction of invalid property interests.

35. As mentioned above, there is a practical legal alternative by which the Debtor can deal with the Purported Holders other than by paying Purported Interests. The Purported Holders

can file claims against the Estate, which allows this Court to determine the rights of all claimants, rather than placing the discretion to spend millions of dollars of Estate funds pre-plan confirmation with the Debtor. The Petitioning Creditors thus object to the Payments of Mineral Interests Motion as it relates to payment of any Purported Interest on a post-petition basis and respectfully request the Court sustain this Objection.

III. RESERVATION OF RIGHTS

36. The Petitioning Creditors reserve the right to amend, modify, or supplement this Objection, including without limitation, to object to and comment on the form of any proposed order submitted to this Court in connection with the Payment of Mineral Interests Motion.

IV. PRAYER

WHEREFORE, PREMISES CONSIDERED, the Petitioning Creditors respectfully request the Court grant the relief requested herein and deny the Debtor's Payments of Mineral Interests Motion as it relates to the payment of ORRIs and Working Interests subject to the Mineral Interest Title Issue, and order such other and further relief the Court deems just and proper.

DATED: September 12, 2024

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CERTIFICATE OF SERVICE

I hereby certify that on September 12, 2024, a true and correct copy of the foregoing was served by the Court's Electronic Case Filing System to all parties registered or otherwise entitled to receive electronic notices.

/s/ Lisa Rothberg
Lisa Rothberg