

What goes up ... a quick glance at Ohio oil and gas leases in bankruptcy

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As Ohio enjoys its latest boom in oil and gas exploration, it is important to understand how oil and gas leases are treated in bankruptcy. Unsettled Ohio law regarding whether a debtor owns unextracted oil and gas as part of the debtor's real property can make this a difficult issue.

In *In re Loveday*, No. 10-64110, 2012 WL 1565479 (Bankr. N.D. Ohio May 2, 2012), the Northern District of Ohio examined whether a Chapter 13 debtor had properly included in his bankruptcy schedules his interest in unextracted oil and gas relating to the debtor's real property. Whether the debtor's oil and gas rights were properly scheduled was a significant factor in determining whether the debtor could retain the proceeds of the sale of his oil and gas rights. But more importantly, for the companies who sought to purchase the debtor's oil and gas rights, knowing whether such rights were properly scheduled was necessary to determine whether the debtor had unfettered authority to sell his oil and gas rights without court approval.

The *Loveday* debtor argued that his oil and gas rights were properly scheduled because these rights were part of his real property, which real property he had listed in his bankruptcy schedules. By operation of law and the debtor's Chapter 13 plan, all the debtor's interest in his properly scheduled assets were vested with the debtor on confirmation of his Chapter 13 plan. Thus, as the debtor argued, because his oil and gas rights were inherently part of his properly scheduled real property, such oil and gas rights were scheduled and the debtor was empowered to sell such rights and entitled to retain the proceeds from the sale.

In testing the debtor's argument, the bankruptcy court outlined two prevailing theories on oil and gas rights - one holding that an owner of real property holds a fee right in unextracted oil and gas that may be severed, and the other holding that rights to oil and gas require actual possession to establish ownership in such oil and gas, and a landowner has the right to reduce the oil and gas to possession or to sever this right for economic consideration. The court found that the "[c]ourts in Ohio are split regarding the treatment of oil and gas rights to an owner," but determined that "the nonownership theory is the more sensible approach to the ownership of oil and gas rights for purposes of valuation in bankruptcy." The court further explained that, "[g]iven the migratory nature of oil and gas, it is premature to give value to the oil and gas before they are extracted from the Land," and held that:

In instances where a debtor retains the oil and gas rights to his property, he has a duty to disclose the retention of these rights on his schedules. ... [T]he debtor cannot assert that the oil and gas rights are included in the value given to the real property on his schedules. When a debtor schedules real property, the court assumes that the debtor refers only to the top surface rights associated with

the real property unless the debtor specifically schedules the retention of other rights associated with the real property. Given how many different rights can be associated with real property, e.g. easements, oil and gas rights, and countless other rights, a debtor need only indicate whether any of these rights have been conveyed, specifically listing which have been conveyed, or indicate that all rights associated with the real property are still retained.

Because the debtor had failed to expressly indicate that his scheduled real property included oil and gas rights, he was required to obtain court approval to sell such rights and retain the proceeds of the sale.

In practice, it would be unusual to find oil and gas rights separately scheduled or expressly noted on a Chapter 13 debtor's bankruptcy schedules. Thus, purchasers of such rights would be wise to condition their acquisition of oil and gas rights on approval by the Chapter 13 debtor's bankruptcy court unless the oil and gas rights are explicitly and unambiguously scheduled.