IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
EMERGE ENERGY SERVICES LP, *et al.*,[1]	:	Case No. 19-11563 (KBO)
	:	
	:	(Jointly Administered)
Debtors.	:	
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RESPONSE OF STOUT EXCAVATING GROUP LLC TO REORGANIZED DEBTORS' FIRST (SUBSTANTIVE) OMNIBUS OBJECTION TO, OR MOTION TO RECLASSIFY, PURPORTED SECURED CLAIMS

Pursuant to 11 U.S.C. §§ 502(b) and 506(a) and Fed. R. Bankr. P. 3007 and Local Bankruptcy Rule 3007-1, Stout Excavating Group, LLC ("Stout"), a creditor in this case, through its undersigned counsel, file this response (the "Response") to the *Reorganized Debtors' First (Substantive) Omnibus Objection to, or Motion to Reclassify, Purported Secured Claims* (the "Omnibus Objection") (Doc. No. 876). In support of its Response, Stout asserts as follows:

PRELIMINARY STATEMENT

The Debtors engage in the mining of silica sand. They have facilities in Wisconsin, Texas, and Oklahoma. Stout holds a properly perfected mining lien against the Debtors' mining-related real estate and personal property located in Bexar County, Texas. Throughout this case, Stout has asserted that its liens are superior to those of the Debtors' lenders on certain assets (namely, certain personal property located in Bexar County, Texas). Stout raised these assertions in its objection to the Debtors' request for debtor-in-possession financing, in its objection to confirmation of the Debtors' plan, and in an adversary proceeding in which it requested a determination under 11

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Emerge Energy Services LP (2937), Emerge Energy Services GP LLC (4683), Emerge Energy Services Operating LLC (2511), Superior Silica Sands LLC (9889), and Emerge Energy Services Finance Corporation (9875). The Debtors' address is: 5600 Clearfork Main Street, Suite 400, Fort Worth, Texas 76109.

U.S.C. § 506(a) as to the extent and priority of its liens. Those issues have routinely been reserved for later determination. In their Omnibus Objection, the Debtors now argue that Stout does not hold a valid mining lien under Texas law.

BACKGROUND

1. The above-captioned debtors (collectively, the "Debtors"), including Superior Silica Sands, LLC ("Superior"), each filed for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code") on July 15, 2019 (the "Petition Date").

2. The Debtors, through the operations of Superior, engage in the mining, processing, and distribution of silica sand for use in hydraulic fracturing (or "fracking") of oil and gas wells. Superior has silica mining facilities in Wisconsin, Texas, and Oklahoma.

3. Stout is an excavation company. It contracted with Superior to provide excavating and mining services to Superior's facilities in Bexar County, Texas (the "San Antonio Facility"). Under the terms of the mining services agreement, Stout was to receive compensation for services performed.

4. Stout has asserted statutory lien rights under Chapter 56 of the Texas Property Code.

5. Stout filed a timely proof of claim in this case. Stout also filed a notice of perfection of lien pursuant to 11 U.S.C. § 546(b)(2).

6. As reflected in its timely-filed proof of claim, Stout is owed $3,274,933.93 for pre-petition mining services which form the basis of its lien claim.

PROCEDURAL HISTORY OF THE CASE

7. On the Petition Date, the Debtors filed a variety of so-called "First-Day Motions," including a *Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Administrative Expense Status, (C) Use Cash Collateral of Prepetition Secured Parties, and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (III) Granting Related Relief* [Doc. No. 20] (the "Financing Motion").

8. In the Financing Motion, Superior and the other Debtors asserted that they were parties to certain first and second lien obligations with HPS Investment Partners LLC as administrative and collateral agent on behalf of the "First Lien Prepetition Lenders" and the "Second Lien Prepetition Noteholders." Financing Motion, ¶ 5.

9. In the Financing Motion, Superior and the other Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the First Lien Prepetition Lenders "not less than $66,710,000, plus accrued and unpaid interest and fees with respect thereto." *Id.*

10. In the Financing Motion, Superior and the other Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the Second Lien Prepetition Noteholders "not less than $215,755,307, plus accrued and unpaid interest and fees with respect thereto." *Id.*

11. In the Financing Motion, Superior and the other Debtors asserted that the First Lien Prepetition Lenders and the Second Lien Prepetition Noteholders (collectively, the "Pre-petition

Lenders") were secured creditors holding liens on the "Pre-petition Collateral" identified in the respective loan documents. Financing Motion, ¶ 6.

12. In the Financing Motion, the Debtors asserted that the Pre-petition Collateral "comprises **substantially all** of the Debtors' assets." Financing Motion, ¶ 7 (Emphasis added).

13. In the Financing Motion, the Debtors sought approval of debtor-in-possession financing from the Pre-petition Lenders who would, as to the post-petition loans, be identified as the "DIP Lenders."

14. Stout filed an objection to the Financing Motion. [Doc No. 134]. In the objection, Stout asserted that its liens were superior to those of HPS on certain assets and reserved all rights associated with their assertion of "Senior Liens" or "Prior Permitted Liens" as those terms were defined in the DIP financing agreement and order. As noted above, throughout this case Stout has consistently denied any characterization that the Pre-petition Collateral (as defined by the Debtors) includes all or "substantially all" of the Debtors assets, at least insofar as it concerns collateral to which Stout's liens attach.

15. The final order granting the Financing Motion and approving the DIP financing agreement (the "Final DIP Order") provided that HPS, on behalf of the DIP Lenders, would receive junior liens on any collateral that was subject to "valid, perfected and unavoidable liens senior to the Prepetition Liens in existence immediately prior to the Petition Date." Final DIP Order, ¶ 13(a)(iii). [Doc. No. 209].

16. The "DIP Financing Agreement," as approved, recognizes the possible existence of "Prior Permitted Liens" which would include certain valid, perfected, and unavoidable liens in favor of third parties. See § 7.2 of the DIP Financing Agreement attached to the Final DIP Order;

and definitions of "Permitted Encumbrances" and "Prior Permitted Liens" contained therein at Section 1.2, pp. 23 and 26.

17. The resolutions of Stout's objections to the Financing Motion specifically preserved and reserved all issues as to lien priority and the extent or validity of its lien rights, as well as any valuation issues.

18. Under the Final DIP Order, the Debtors' stipulations as to the validity and priority of the liens of the Pre-petition Lenders were not binding upon other parties for a period of 75 days after entry of the order approving DIP financing (the "Challenge Period") so as to permit certain so called "Challenges" to be lodged. These Challenges were to include objections to the stipulated valuation of assets as well as issues of lien priority. Final DIP Order, ¶ 26.

19. Under the Final DIP Order, the Debtors' stipulations as to the validity and priority of Pre-petition Liens in the Pre-petition Collateral were subject to Challenge if brought within the Challenge Period; otherwise, the stipulations became binding on third parties.

20. The Final DIP Order was entered on August 14, 2019. The Challenge Period therefore expired on October 28, 2019.

21. On October 25, 2019, prior to the expiration of the Challenge Period, Stout filed an adversary complaint (the "Stout Complaint") in the adversary proceeding styled *Stout Excavating Group LLC, v. Superior Silica Sands LLC and HPS Investment Partners LLC,* Adv. No. 19-50729. In the Stout Complaint, Stout sought a determination of the extent and priority of its liens, expressly asserting that its liens on "material, machinery, and supplies" owned by the owner of the mine real property constituted superior liens within the meaning of the Debtors' plan. The Stout

Complaint is docketed at Adv. Pro. No. 19-50729 and is expressly re-alleged and incorporated into this Response.[2]

22. The solicitation version of the disclosure statement (the "Disclosure Statement") for the Debtors' *First Amended Joint Plan of Reorganization* was filed on September 11, 2019 [Doc. No. 363]. After a contested confirmation hearing, the Court initially denied confirmation of the Debtors' plan in an order dated December 6, 2019. [Doc. No. 671, the "Confirmation Decision"]. The Court subsequently entered an order confirming a further amended plan on December 18, 2019 [Doc. No. 719].

23. The Debtors' Second Amended Joint Plan of Reorganization [Doc. No. 682, the "Confirmed Plan"] defines a "Secured Claim" as a claim that is "secured by a Lien on property in which any of the Debtors' Estates have an interest or that is subject to setoff under section 553 of the Bankruptcy Code, *to the extent of the value of the Claim holder's interest in such Estate's interest in such property* or to the extent of the amount subject to setoff, as applicable, *as determined pursuant to section 506(a) of the Bankruptcy Code* or, in the case of setoff, pursuant to section 553 of the Bankruptcy Code." *See* Second Amended Joint Plan of Reorganization, Doc. No. 682, at 17 (emphasis added).

24. The Confirmed Plan defines "Other Secured Claim" as "*any* Secured Claim other than an Administrative Claim, DIP Credit Agreement Claim, Secured Tax Claim, or Prepetition Debt Claim." *Id*. at 13.

25. In the Confirmed Plan, Other Secured Claims were classified as "Class 2." *Id*., at Art. III.B.2.

[2] The parties had agreed to postpone the adversary proceedings pending their efforts at mediation. Mediation ultimately occurred on July 22, 2020 and was unsuccessful.

26. The Confirmed Plan provides that each holder of an allowed Class 2 Claim shall receive, at the "election" of the Debtors or Reorganized Debtors:

> (A) *Cash equal to the amount of such Allowed Class 2 Claim*; (B) such other less favorable treatment as to which the Debtors or Reorganized Debtors, as applicable, and the Holder of such Allowed Class 2 Claim shall have agreed in writing; (C) *the Collateral securing such Allowed Class 2 Claim*; or (D) such other treatment such that it will not be impaired pursuant to section 1124 of the Bankruptcy Code. . . . For the avoidance of doubt, any Lien that secures a Class 2 Claim shall be retained against the applicable Collateral until such Class 2 Claim is paid or reserved in full in Cash or *Disallowed* by order of the Bankruptcy Court.

Id. (emphasis added).

27. As concerns the treatment of construction or mechanics' or materialmen's liens, the Debtors' Disclosure Statement provided as follows:

> In some cases, vendors have asserted liens ("M&M Liens") to secure allegedly accrued and unpaid amounts owing under prepetition contracts with the Debtors. The Debtors are aware of the assertion of M&M Liens filed against various of the Debtors' properties at which the subject work and/or services were allegedly supplied. These properties include Debtor-owned property at Kingfisher, Oklahoma, Kosse, Texas, San Antonio, Texas, and Chippewa County, Wisconsin. The Debtors continue to examine the validity and perfection of such liens and their related claims, as well as the relative priority of any such valid and perfected liens relative to other valid and perfected liens on the affected properties. To the extent any valid and perfected M&M Liens enjoy a priority in respect of the affected property sufficient to render the related claims secured, those claims will be treated as Other Secured Claims under the Plan, while any deficiencies will be treated as General Unsecured Claims. The Debtors continue to reserve all rights in respect of the asserted M&M Liens.

See Disclosure Statement, Article II.C.3.

28. Stout admittedly commenced work on the San Antonio Facility after deeds of trust were recorded against the real property. However, other material, machinery, and supplies used for mineral activities (collectively, the "Mining Personal Property") was located or placed on the real estate. Under Texas law, a valid mining lien on the Mining Personal Property takes priority

over an earlier encumbrance on the land on which the Mining Personal Property is placed or located. As such, Stout's lien against the Mining Personal Property is not subject to reclassification as an unsecured claim.

BASIS FOR RESPONSE

29. Texas Property Code § 56.002 provides that "a mineral contractor or subcontractor has a lien to secure payment for labor or services related to the mineral activities."

30. Under Texas Property Code § 56.003, the following property is subject to a mining lien: (i) the material, machinery, and supplies furnished or hauled by the lien claimant; (ii) the land for which the labor was performed or material, machinery, or supplies was furnished or hauled, together with the buildings and appurtenances on the property; and (iii) other material, machinery, and supplies used for mineral activities (the "Mining Property") owned by the owner of the mine real property.

31. In their Omnibus Objection, the Debtors' appear to acknowledge that under Texas law, a lien on "material, machinery, supplies or a specific improvement" does in fact take precedence over an earlier deed of trust. *See* Doc. No. 876 at ¶ 22 ("the only part of the mining lien that can take priority is "[t]he lien on material, machinery, supplies, or a specific improvement"). As reflected in the Stout Adversary Complaint, Stout has consistently asserted a superior lien on exactly *those items* – i.e., all material, machinery, and supplies located at the San Antonio Facility. Given the Debtors' apparent concession on this point, it is unclear exactly what the Debtors are actually arguing in the rest of this paragraph of the Omnibus Objection, as they do not appear to contend that there are no such items located *on* the real property. As a result, Stout's lien on any such items should be viewed as superior to the prior recorded deeds of trust.

32. Instead, the Debtors' primary contention appears to be that Stout *cannot* hold a mining lien because "sand" is not "part of a property's mineral estate." From this, they contend that excavation of sand therefore does not constitute "mineral activities" within the meaning of Chapter 56. *See* Doc. No. 876 at ¶ 22 n. 9. While the Debtors contend they are not "aware" of any decision holding that suppliers of labor "in respect of sand excavation" come within the ambit of Chapter 56," the corollary is likewise true: there appear to be no cases which find that sand excavation does *not* fall within the ambit of Chapter 56.

33. In truth, however, the Debtors' are misreading Chapter 56 of the Texas Property Code. Under that chapter, "mineral activities" are not defined in relation to the distinction the law typically draws between "surface rights" and "mineral rights." Instead, "mineral activities" is expressly defined in Chapter 56 as meaning "*digging*, drilling torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or *a mine or quarry*." *See* Texas Property Code § 56.001(1) (Emphasis added). In addition, a "mineral property owner" is simply defined as including an "owner of land" and a "mineral contractor" means a person who performs labor, services, or supplies used in mineral activities under a contract with a "mineral property owner." *See* Texas Property Code §§ 56.001(2) and (3).

34. The distinction here is critical, because while "sand" and other substances are generally viewed as being part of the surface, rather than the mineral estate, that does not mean activities by which one engages in the *extraction* of those substances is somehow not "mining."

35. The case cited by the Debtors for support of their argument that sand extraction can somehow be distinguished from "mining activities" under Chapter 56 is inapplicable. Instead, it simply reflects that the courts have long had trouble distinguishing between the "surface" and the "mineral estate" when the rights of owners are separated. *See Moser v. U.S. Steel Corp.*, 676

S.W.2d 99, 102 (Tex. 1984). In that case, the court held that a severance of minerals in an "oil, gas and other minerals clause" encompassed uranium, but the court reaffirmed its prior rulings as to substances which would also normally be viewed as part of the surface estate as a matter of law, including building stone, limestone, caliche, surface shale, iron, and coal. Presumably, the Debtors do not also suggest that coal mines are not "mines."

36. The Texas Supreme Court has also noted the term "quarry" as being an "open excavation" for obtaining substances like stone, slate, or limestone (all of which, notably, are not part of the "mineral" estate), and that the term "quarry" means more than "merely the excavation existing during the extraction or a source of supply or left after a source of supply has been extracted." *Gifford-Hill & Co., Inc. v. Wise County Appraisal Dist.*, 827 S.W.2d 811, 815 (Tex. 1991).

37. For purposes of a lien under Chapter 56, it is not required that the activity relate to the "mineral estate." The Debtors can point to no statutory limitation or any case which has held as much. Instead, under the clear and unambiguous language of the statute, when determining if there were "mineral activities," is sufficient that the claimant performed services – such as "digging" or excavation – in connection with a "mine or quarry" on the Debtors' land, and under a contract with the Debtors. That is the case here, and accordingly Stout is entitled to a mining lien under Chapter 56. Because Stout holds a mining lien, that lien is therefore superior to prior liens on any "material, machinery, [and] supplies" located at the San Antonio Facility pursuant to Texas Property Code §56.004.

RESERVATION OF RIGHTS

38. Stout reserve all rights, claims, defenses, and remedies, including the ability to supplement or amend this Response to the extent permitted by rule, to request any needed

discovery, and to raise additional objections should the evidence as presented warrant such objections, including Debtors' compliance with L.R. 3007-1(f)(iii). Stout also joins in any other responses to the Omnibus Objection to the extent such objections are not inconsistent with this Response.

CONCLUSION

For the foregoing reasons, Stout requests that the Court enter an Order: (i) sustaining the Response; (ii) denying the Omnibus Objection; (iii) scheduling a hearing under § 506(a) to determine the extent and priority of Stout's Allowed Secured Claims; and (iv) granting such other and further relief as the Court deems just and proper.

Date: September 10, 2020
Wilmington, DE

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CERTIFICATE OF SERVICE

I, Elihu E. Allinson, III, do hereby certify I am not less than 18 years of age and that on this 10th day of September, 2020, I caused copies of the within *Response of Stout Excavating Group, LLC to Reorganized Debtors' First (Substantive) Omnibus Objection to, or Motion to Reclassify, Purported Secured Claims* to be served upon the parties listed below via Electronic Mail. All other parties who have signed up for electronic filing in this case will receive electronic notice via CM/ECF.

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September 10, 2020
Date

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