UT LAW CLE | THE UNIVERSITY OF TEXAS SCHOOL OF LAW

PRESENTED AT

47th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute and Fundamentals

March 25-26, 2021
Live Webcast

Update on Midstream Agreements in Bankruptcy: From *Sabine* to *Southland* and Beyond

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UPDATE ON MIDSTREAM AGREEMENTS IN BANKRUPTCY: FROM *SABINE* TO *SOUTHLAND* AND BEYOND*

I. INTRODUCTION.

The new controversy over old law continues today: covenants running with the land, executory contracts, or both?[1] The characterization of midstream agreements, and the impact of that characterization on a debtor's ability to jettison such agreements through the bankruptcy process, continues to profoundly impact the U.S. oil and gas industry. In 2020 alone, forty-six producers with combined debt in excess of $53 billion initiated bankruptcy proceedings to restructure their over-levered balance sheets.[2] At the forefront of many recent bankruptcies, producers and midstreamers squared off over not only the characterization of various midstream agreements, but the extent to which their characterization as a real property interest immunizes them from rejection. By the end of 2020, a "split between bankruptcy courts regarding the enforceability of gas gathering agreements in whole or in part as real property covenants" had clearly emerged. [3]

(A) The Upstream / Midstream Commercial Bargain.

Over the last twenty years, midstream companies have collectively invested hundreds of billions of dollars in developing the infrastructure necessary to gather, process, and transport domestic oil and gas.[4] While midstream capital expenditures have tailed off from their peak in

* The authors would like to thank Gray Reed associates Brittany M. Blakey and Ethan M. Wood for their assistance in the preparation of this paper.

[1] Some authors of this paper addressed this issue in a prior article. *See* Jonathan M. Hyman and Philip B. Jordan, *When Does a Gas Dedication Create a Real Property Interest? A Post-Sabine Analysis of Covenants Running with the Land*, 12 TEX. J. OIL, GAS, AND ENERGY L. 177 (2017).

[2] Haynes and Boone, *Haynes and Boones Oil Patch Bankruptcy Monitor*, *available at* https://www.haynesboone.com/-/media/Files/Energy_Bankruptcy_Reports/Oil_Patch_Bankruptcy_Monitor (Dec. 31 2020).

[3] *In re Southland Royalty Co. LLC*, 623 B.R. 64, 79 (Bankr. D. Del. 2020) (Owens, J.).

[4] For the period from 1998 through 2013, interstate pipeline capacity expenditures totaled more than $63 billion, and nearly 127 Bcf/d of pipeline capacity was added. U.S. DEPARTMENT OF ENERGY, OFFICE OF ENERGY POLICY AND SYSTEMS ANALYSIS, *Natural Gas Infrastructure Implications of Increased Demand from the Electric Sector*, Feb/ 2015 *available at* http://energy.gov/epsa/qer-document-library; From 2004-2014, companies made an average of $10 billion annual investment in midstream natural gas infrastructure, including major pipeline projects. U.S. DEPARTMENT OF ENERGY, OFFICE OF ENERGY POLICY AND SYSTEMS ANALYSIS, *Energy Transmission, Storage, and Distribution Infrastructure*, Appendix B Natural Gas at p. NG-5, *available at* http://energy.gov/sites/prod/files/2015/09/f26/QER_AppendixB_NaturalGas.pdf. Reported and completed U.S. natural gas pipeline projects from 2010 to 2020 have totaled over $28.2 billion. U.S. ENERGY INFORMATION ADMINISTRATION, *Natural Gas Pipeline Projects*, *available at* https://www.eia.gov/naturalgas/data.php#pipelines (released Jan. 1, 2021). U.S. Capital expenditures for new oil and gas infrastructure development have been projected to total $791 billion from 2018 through 2035, which averages to

2018-2019, between 2016 and 2018 well over seventy-percent of major public midstream companies increased their capital expenditures.[5] In exchange for deploying this capital, midstream companies contracted with producers for a promise of payment based on the volume of oil and gas gathered, processed, or transported and received dedications of the underlying oil and gas interests/mineral interests and associated acreage. The fees charged to producers under gathering and processing contracts are designed to provide midstream companies, over a period of time, a return of and on their capital investment.

From the midstream perspective, the dedications contained in gathering and processing agreements operate as security by burdening the oil and gas interests, thereby binding all successors to the terms of the original bargain. Midstream companies have historically undertaken large capital investments, and their lenders have financed these midstream projects, with the understanding that these dedications are real property interests that bind successors to the mineral interests. That is, regardless of any change to the leasehold ownership, which frequently occurs, any hydrocarbons produced from the subject acreage remain dedicated to the midstream company and subject to the terms of the gathering and processing contracts.

(B) A Developing Split Among Bankruptcy Courts Regarding the Characterization of Midstream Agreements and the Impact of Such Characterization on a Debtor's Ability to Reject Midstream Agreements as Executory Contracts.

Prior to 2020, only three bankruptcy courts had grappled with the application of arcane property law principles to a producer's efforts to dispose of out of market midstream agreements through the restructuring process: (1) *In re Sabine Oil & Gas Corp.*, 550 B.R. 59 (Bankr. S.D.N.Y. 2016), *aff'd*, 567 B.R. 869 (S.D.N.Y. 2017), *aff'd*, 734 F. App'x 64 (2d Cir. 2018) (Chapman, J.) ("***Sabine***"); (2) *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854 (Bankr. D. Colo. 2019) (Tyson, J.) ("***Badlands***"); and (3) *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 100 (Bankr. S.D. Tex. 2019) (Isgur, J.) ("***Alta Mesa***"). *Sabine*, a 2016 opinion, held the gathering agreements at issue did not form covenants running with the land, constituted mere executory contracts, and were therefore

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$44 billion per year. ICF, *North America Midstream Infrastructure through 2035: Significant Development Continues*, at 3, THE INGAA FOUNDATION (June 18, 2018), *available at* https://www.ingaa.org/File.aspx?id=34658.

[5] Michael Laitkep, *After Years of Growth, Is Midstream Capex Peaking?*, ALERIAN (May 7, 2019), available at https://insights.alerian.com/after-years-of-growth-is-midstream-capex-peaking.

subject to rejection by Sabine, the producer / debtor. The *Badland*s and *Alta Mesa* opinions, both issued in late 2019, reached the opposite conclusion, finding the gathering and salt water disposal agreements at issue created covenants running with the land—a real property interest—and as such, were immune from the producer / debtor's efforts to dispose of them through restructuring.

In 2020, bankruptcy courts issued three covenant running with the land opinions (1) *Extraction Oil & Gas, Incorporated v. Elevation Midstream, LLC (In re Extraction)*, 2020 Bankr. LEXIS 2855, Adv. Proc. No. 20-50839 (Bankr. D. Del. Oct. 14, 2020). (Sontchi, C.) ("***Extraction***"); (2) *In re Chesapeake Energy Corp.*, 622 B.R. 274 (Bankr. S.D. Tex. 2020) (Jones, D.) ("***Chesapeake***"); and (3) *In re Southland Royalty Co. LLC*, 623 B.R. 64 (Bankr. D. Del. 2020) (Owens, K.) ("***Southland***"). These opinions, *Extraction* and *Southland* in particular, significantly altered the landscape of covenant running with the land litigation. Prior to *Southland* and *Extraction*, it was widely accepted that the determination of whether a midstream contract created a covenant running with the land was dispositive of whether the agreement constituted a real property interest (in which case a debtor could not reject the agreement in bankruptcy) or an executory contract (in which case the debtor was free to shed the contract).[6] In *Extraction* and *Southland*, the courts determined the midstream agreements at issue failed to create covenants running with the land—but then took an additional and unprecedented step. Both the *Extraction* and *Southland* courts concluded that even had they determined the midstream agreements created covenants running with the land, the agreements would still have been executory contracts subject to rejection under the Bankruptcy Code.[7]

As Judge Owens observed in *Southland*, there are effectively two judicial approaches to construing midstream agreements.[8] The *Sabine*, *Extraction*, and *Southland* opinions (the "***Upstream Approach***") from the New York and Delaware bankruptcy courts, respectively, represent an "upstream friendly" position on whether midstream agreements form covenants running with the land. Conversely, the *Alta Mesa* and *Badlands* opinions (the "***Midstream Approach***") issued by bankruptcy judges in Texas and Colorado, respectively, represent a "midstream friendly" position on whether midstream agreements form covenants

[6] *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 98 (Bankr. S.D. Tex. 2019) ("Alta Mesa cannot reject the gathering agreements because the agreements are not executory contracts. Real property covenants are not executory and are not subject to rejection. As discussed [in *Alta Mesa*], the gathering agreements form real property covenants running with the land.").
[7] See *In re Extraction Oil & Gas*, 622 B.R. 608, 623 (Bankr. D. Del. 2020) and *Southland*, 623 B.R. at 96–98.
[8] *Southland*, 623 B.R. at 79.

running with the land. The *Chesapeake* opinion (the "***Middle Ground***") recently issued by a Texas bankruptcy judge may represent an attempt to find common ground between the Upstream Approach and Midstream Approach. As a result, a producer / debtor's ability to reject an out of market midstream agreement may largely depend on its chosen venue and the approach employed by that venue.

(C) Oil & Gas Bankruptcy Basics: Executory Contracts versus Real Property Interests

Section 365(a) of the Bankruptcy Code provides that a debtor in possession may assume or reject any "executory contract"[9] or unexpired lease.[10] Additionally, any decision by the debtor to assume or reject an executory contract or unexpired lease is subject to the "business judgment test" applied by the courts.[11] Although the business judgment test is relatively easy to satisfy,[12] if a court finds that rejection of an executory contract would be a detriment to the debtor's estate rather than a benefit, it may refuse to approve the rejection.[13] Rejection constitutes a breach of the agreement, and such breach is effective immediately before the date of the bankruptcy filing.[14] A claim for rejection damages is calculated pursuant to the terms of the contract under non-

[9] Although the Bankruptcy Code does not define what constitutes an "executory contract," the legislative history and an overwhelming majority of courts addressing the issue employ the "Countryman definition," which defines an executory contract as "a contract under which the parties' obligations are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy (Part I)*, 57 MINN. L. REV. 439, 460 (1973); *In re Murexco Petroleum, Inc*., 15 F.3d 60, 62-63 (5th Cir. 1994); *see also Stewart Title Guaranty Co. v. Old Republic National Title Ins. Co.*, 83 F.3d 735, 741 (5th Cir. 1996).

[10] 11 U.S.C. § 365(a). This assumption or rejection is conditioned upon approval by the bankruptcy court. *Id.*

[11] *Richmond Leasing Co. v. Capital Bank, N.A. (In re Richmond Leasing Co.)*, 762 F.2d 1303, 1309 (5th Cir. 1985) ("It is well established that the question [of] whether a lease should be rejected . . . is one of business judgment"); *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1099 (2d Cir. 1993).

[12] See, e.g., *Richmond Leasing*, 762 F.2d at 1309; *In re Pilgrim's Pride Corp.*, 403 B.R. 413, 426 (Bankr. N.D. Tex. 2009) ("In applying the business judgment rule in deciding whether to grant a debtor's motion to reject a contract a court is not adjured to blindly accept, but rather only to show proper deference to the business judgment of the debtor's management").

[13] *In re Angelika Films 57th Inc.*, No. 97 Civ. 2239 (MBM), 1997 WL 283412, at *6 (S.D.N.Y. May 29, 1997) (affirming bankruptcy court finding that debtor did not exercise its business judgment in a manner consistent with the estate's best interest by seeking to assume and assign movie theater lease); *In re Matusalem*, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) (debtor failed to demonstrate good business judgment for seeking to reject sub-franchise agreement for use of licensed intellectual property, as rejection would result in no economic benefit to the estate and its creditors and would "utterly destroy" the debtor's business).

[14] 11 U.S.C. § 365(g)(1)

bankruptcy law and is treated as a prepetition general unsecured claim.[15] Conversely, real property interests are not executory and cannot be rejected under section 365(a).[16]

Producers and midstream companies are at odds over whether gathering and processing agreements create real property interests, thereby effectively removing the agreement from the debtor's bankruptcy estate and potentially insulating them from rejection, or (2) garden variety executory contracts that may be rejected through the bankruptcy process.[17] Because state law determines property rights in the assets of a debtor's estate, analysis of state law where the upstream and midstream assets are located is required. [18] The following is a discussion of applicable Texas case law. [19]

II. SUMMARY OF TEXAS CASE LAW.

Under Texas law, a covenant runs with the land when (1) it touches and concerns the land; (2) it relates to a thing in existence or specifically binds the parties and their assigns; (3) the original parties intended it to run with the land; (4) the successor to the burden has notice; and (5) privity of estate existed between the parties when the covenant was made.[20] Additionally, equitable servitudes may be binding upon successors to burdens on land even if they fail the legal test for covenants running with the land (specifically, horizontal privity).[21] Texas law considers

[15] 11 U.S.C. § 502(g)(1).
[16] *See, e.g., Gouveia v. Tazbir*, 37 F.3d 295, 299 (7th Cir. 1994); *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.),* 613 B.R. 90, 100 (Bankr. S.D. Tex. 2019) ("Contracts forming real property covenants are not executory."); *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 875 (Bankr. D. Colo. 2019) (same).
[17] *See, e.g., In re Sabine Oil & Gas Corp.*, 550 B.R. 59 (Bankr. S.D.N.Y. 2016), *aff'd*, 567 B.R. 869 (S.D.N.Y. 2017), *aff'd*, 734 F. App'x 64 (2d Cir. 2018); *In re Quicksilver Resources Inc., et al*, Case No. 15-10585 (Bankr. D. Del. 2016).
[18] *Butner v. United States*, 440 U.S. 48, 54 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").
[19] The covenant running with the land analysis only applies to intrastate pipeline system. Interstate pipeline systems are governed by FERC. Bankruptcy courts asked to consider the characterization of FERC-regulated pipeline agreements have overwhelming found them to be executory contracts subject to rejection under section 365(a). *See, e.g. In re Ultra Petroleum Corp*., No. 20-32631, 2020 WL 4940240, at *6 (Bankr. S.D. Tex. Aug. 21, 2020). An in-depth discussion of the intersection of FERC and bankruptcy law is outside the scope of this article.
[20] *Inwood N. Homeowners' Ass'n v. Harris*, 736 S.W.2d 632, 635 (Tex. 1987); *Ehler v. B.T. Suppenas Ltd.*, 74 S.W.3d 515, 521 (Tex. App.—Amarillo 2002, no pet.).
[21] *TX Far West, Ltd. v. Tex. Inv. Mgmt., Inc.*, 127 S.W.3d 295, 302 (Tex. App.—Austin 2004, no pet.); *Collum v. Neuhoff*, 507 S.W.2d 920, 922 (Tex. Civ. App.—Dallas 1974, no writ).

both covenants running with the land and equitable servitudes as real property rights rather than contractual rights.[22] This section will discuss each in turn. [23]

(A) Elements at Issue with Respect to Midstream Agreements

The elements at issue with respect to midstream agreements usually involve (1) touch and concern, (2) intent, and/or (3) privity of estate. Generally, a covenant touches and concerns the land when it affects the "nature, quality or value of the thing demised, independently of collateral circumstances, or it affect[s] the mode of enjoying it."[24] A covenant must burden the land to satisfy the touch and concern requirement; arguably no corresponding benefit to the land is necessary.[25] The burden must directly impact the land itself and its value, not just the parties personally.[26]

Unsurprisingly, an agreement explicitly stating that it "runs with the land" is typically sufficient evidence establishing the element of intent,[27] although it is not dispositive.[28] When the agreement does not contain such a statement, courts look to the agreement to determine whether the parties intended to bind successors in interest to the agreement.[29] Language binding the parties and their "successors and assigns" may be evidence of the requisite intent.[30] Additionally, evidence

[22] *Davis v. Skipper*, 125 Tex. 364, 365, 83 S.W.2d 318, 321 (Comm'n App. 1935).
[23] It is worth noting that other oil producing states largely have similar elements establishing a covenant running with the land. *See Reishus v. Bullmasters, LLC*, 409 P.3d 435, 440 (Colo. App. 2016) and *Taylor v. Melton*, 274 P.2d 977, 978–79 (Colo. 1954) (each outlining Colorado elements); *Lex Pro Corp. v. Snyder Enters., Inc.*, 671 P.2d 637, 639 (N.M. 1983) (outlining New Mexico elements); *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 100 (Bankr. S.D. Tex. 2019) (outlining Oklahoma elements); *Flying Diamond Oil Corp. v. Newton Sheep Co.*, 776 P.2d 618, 623, 629 (Utah 1989) (outlining Utah elements); and *Pennaco Energy, Inc. v. KD Co. LLC*, 363 P.3d 18, 33–34 (Wyo. 2015) (citing *Lingle Water Users' Ass'n v. Occidental Bldg. & Loan Ass'n*, 297 P. 385, 387 (Wyo. 1931)) (outlining Wyoming elements).
[24] *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 911 (Tex. 1982). In contrast, personal covenants do not touch and concern the land because such covenants only affect the grantor personally and do not relate to the use of land. *Id*.
[25] *In re El Paso Refinery, L.P.*, 302 F.3d 343, 356 (5th Cir. 2002); *Wimberly v. Lone Star Gas Co.*, 818 S.W.2d 868, 871 (Tex. App.—Fort Worth 1991, pet. denied).
[26] *See, e.g.*, *Westland Oil*, 637 S.W.2d at 911; *Wimberly*, 818 S.W.2d at 970-71; *El Paso Refinery*, 302 F.3d at 357-58.
[27] *See, e.g.*, *Newco Energy v. Energytec, Inc.*, 739 F.3d 215, 217 (5th Cir. 2013); *In re Beeter*, 173 B.R. 108, 111 (Bankr. W.D. Tex. 1994).
[28] *See, e.g.*, *Chesapeake Energy Corp.*, 622 B.R. at 279-80.
[29] *Monfort v. Trek Resources, Inc.*, 198 S.W.3d 344, 355 (Tex. App.—Eastland 2006, no pet.); *Musgrave v. Brookhaven Lake Prop. Owners Ass'n*, 990 S.W.2d 386, 395 (Tex. App.—Texarkana 1999, pet. denied).
[30] *Barnes S.W. Plaza, LLC v. WF Retail Investments LLC*, No. 02-11-00244-CV, 2012 WL 3758086, at *4 (Tex. App.—Fort Worth Aug. 30, 2012, no pet.).

of intent may be inferred from the filing of the agreement or a memorandum thereof in the county deed records.[31]

Lastly, for a covenant to run with the land, the covenant must be made between parties who are in "privity of estate," which means "there must be a mutual or successive relationship to the same rights in the property."[32] Some Texas intermediate courts of appeal have required horizontal privity, which requires the covenant be created as part of a conveyance of real property.[33] It is unclear whether the Texas Supreme Court requires horizontal privity to form a covenant running with the land.

(B) Equitable Servitudes

As noted above, equitable servitudes are an alternative way that a covenant can bind successors to burdens on land.[34] An equitable servitude is binding on successors to real property if: (1) the successor to the burdened land took its interest with notice of the restriction;[35] (2) the covenant limits the use of the burdened land;[36] and (3) the covenant benefits the land of the party seeking to enforce it.[37] Horizontal privity is unequivocally not a requirement to form an equitable servitude.[38] As with covenants running with the land, equitable servitudes are real property interests under Texas law. [39]

III. MIDSTREAM APPROACH: *ALTA MESA* AND *BADLANDS*.

Generally, midstream agreements in jurisdictions that embrace the Midstream Approach may survive rejection because they form a covenant running with the land. The Midstream Approach considers the midstream agreement an integral part of the oil and gas production process

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[31] *Harris County Flood Control Dist. v. Glenbrook Patiohome Owners Ass'n*, 933 S.W.2d 570, 575 (Tex. App.—Houston [1st Dist.] 1996, writ denied).
[32] *Westland Oil*, 637 S.W.2d at 910-11.
[33] *Energytec*, 739 F.3d at 222; *Wayne Harwell Props. v. Pan Am Logistics Ctr.*, 945 S.W.2d 216, 218 (Tex. App.—San Antonio 1997, writ denied) ("the covenant must be made between parties who are in privity of estate at the time the covenant is made, and must be contained in a gant of the land or in a grant of some property interest in the land").
[34] *TX Far West, Ltd. v. Tex. Inv. Mgmt., Inc.*, 127 S.W.3d 295, 302 (Tex. App.—Austin 2004, no pet.); *Collum v. Neuhoff*, 507 S.W.2d 920, 922 (Tex. Civ. App.—Dallas 1974, no writ).
[35] *Collum*, 507 S.W.2d at 922-23.
[36] *Clear Lake City Water Auth. v. Clear Lake Util.*, 549 S.W.2d 385, 388 (Tex. 1977).
[37] *Davis v. Skipper*, 125 Tex. 364, 365, 83 S.W.2d 318, 321 (1935); *Reagan Nat. Advert. of Austin, Inc. v. Capital Outdoors, Inc.*, 96 S.W.3d 490, 496 (Tex. App.—Austin 2002, pet. granted, judgm't vacated w.r.m.).
[38] *See Collum*, 507 S.W.2d at 922.
[39] *Davis*, 83 S.W.2d at 321 (Comm'n App. 1935).

without which oil and gas could not be produced.[40] And because the midstream agreement is integral to the production process, the midstream agreement impacts the use, value or enjoyment of the underlying mineral estate (satisfying the touch and concern element). Courts applying the Midstream Approach have also held (1) conveyances of (a) floating easements and (b) surface easements and rights-of-way upon which midstream infrastructure was constructed, and (2) the dedication itself, satisfy privity of estate.[41] The two prominent cases embracing the Midstream Approach are *Alta Mesa*, applying Oklahoma law, and *Badlands*, applying Utah law. Both bankruptcy courts found midstream agreements to be covenants running with the land, and thus held they could not be rejected.

1. *Alta Mesa*.

In *Alta Mesa*, the producer Alta Mesa sought to reject its midstream agreement with commonly-owned Kingfisher Midstream, LLC.[42] Kingfisher objected to the motion to reject, arguing the dedication in the midstream agreement was a covenant running with the land that could not be rejected in bankruptcy.[43] Alta Mesa dedicated its "mineral interests in lands, leases, wells, and Gas producer owns or controls within the Dedication Area" to Kingfisher.[44]

(A) Touch and Concern

In analyzing the touch-and-concern requirement, the court found "[t]he [midstream] agreements touch and concern the Alta Mesa oil and gas leases because both the benefits and the burdens of the covenants affect the value of Alta Mesa's real property interests."[45] The court went

[40] "Just as a home without access to a road is less valuable than one facing the street, a solitary oil and gas lease is less valuable than one attached to a gathering grid." *In re Alta Mesa*, 613 B.R. 90, 104 (Bankr. S.D. Tex. 2019).
[41] The *Badlands* court expressly held the dedication constituted a conveyance satisfying both horizontal and mutual privity. *Badlands*, 608 B.R. 873–74 (Bankr. D. Colo. 2019). In *Alta Mesa*, the court held the midstream agreement conveyed the producer's floating easement without pointing to any specific conveyance language. *Alta Mesa*, 613 B.R. at 106. Therefore, it is arguable the *Alta Mesa* court concluded the dedication itself conveyed the producer's floating easement.
[42] *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 95 (Bankr. S.D. Tex. 2019).
[43] *Id*.
[44] *Plaintiffs' Motion for Summary Judgment Pursuant to Fed. R. Bankr. P. 7056 with Respect to Debtors' Adversary Complaint for Declaratory Relief*, ECF No. 107 Ex. 1 (2015 GGA) §1.1; Ex. 4 (2016 GGA) §1.1.
[45] *Alta Mesa*, 613 B.R. at 102.

to great lengths to identify the specific real property burdened and benefited by the dedication—Alta Mesa's oil and gas leases.[46]

After defining the real property interest at issue, the court discussed both the benefits and burdens on the leases.[47] First, the court explained the dedication enabled Kingfisher to build a modern gathering system, which benefited the leases by facilitating the collection of produced reserves, describing the benefit to the leases as follows:

> Once a well is linked to an accessible gathering system, the system not only benefits the produced reserves as they travel towards collection, it enhances the value of unproduced reserves which may be extracted in the future. Just as a home without access to a road is less valuable than one facing the street, a solitary oil and gas lease is less valuable than one attached to a gathering grid.[48]

The court then explained the dedication also burdened Alta Mesa's leases because it (1) granted Kingfisher a portion of Alta Mesa's implied easement in the leases—which easement was carved out of Alta Mesa's leasehold interest, thus reducing Alta Mesa's real property interest; (2) restricted Alta Mesa's use of its reserves; and (3) reduced the value of Alta Mesa's reserves in a depressed hydrocarbon market because of the fixed fee arrangement.[49]

Although acknowledging Kingfisher's right to delivery is conditioned on extraction, unlike the *Sabine* court (as discussed below), the *Alta Mesa* court did not find this fact to be dispositive: "[w]hile Kingfisher's right to delivery springs at the instant when the reserves reach the surface and become personal property, its interest has touched and concerned Alta Mesa's mineral leases since the execution of the gathering agreements."[50] Therefore, the agreements satisfied Oklahoma's touch and concern standard.[51]

(B) Horizontal Privity

Similar to *Badlands* (as discussed below), but without a detailed discussion of the distinction between mutual and horizontal privity, the *Alta Mesa* court considered whether the

[46] *Id*.
[47] *Id*. at 103–05.
[48] *Id*. at 104.
[49] *Id*.
[50] *Id*. at 105.
[51] *Id*. at 102.

conveyance of implied lease easements was sufficient to satisfy horizontal privity.[52] Under Oklahoma law, oil and gas leases create an implied surface easement for the exploration and production of oil and gas.[53] The *Alta Mesa* court found Alta Mesa's conveyance of the implied lease easement transferred a "possessory interest in Alta Mesa's leasehold estate" to Kingfisher, satisfying horizontal privity.[54] However, the court's opinion does not reference a specific conveyance in the agreement between Alta Mesa and Kingfisher.[55] In the absence of specific conveyance language, it is reasonable to conclude the dedication conveyed Alta Mesa's implied lease easement to Kingfisher.

For these reasons, the United States Bankruptcy Court for the Southern District of Texas held the dedication was a covenant running with the land under Oklahoma law.[56]

2. *Badlands*.

In *Badlands*, Badlands sought to sell its Utah oil and gas assets to Wapiti Utah free and clear of all liens, claims, and encumbrances.[57] Monarch was a party to midstream agreements with Badlands. Monarch objected to the sale of the assets free and clear of its agreements, arguing they could not be rejected in bankruptcy because the dedications contained therein were covenants running with the land.[58]

The gathering dedication provided as follows: "Producer … exclusively dedicates and commits to the performance of this Agreement the Dedicated Reserves[.]"[59] "Dedicated Reserves" were defined as

> the interest of Producer in all Gas reserves in and under, and all Gas owned by Producer and produced or delivered from … the Leases and … other lands within the AMI, whether now owned or hereafter acquired … and any and all additional right, title, interest, or claim of every kind and character of Producer or its Affiliates in (x) the Leases or (y) lands within the AMI, and Gas production therefrom, and

[52] *Id*.
[53] *Hinds v. Phillips Petroleum Co.*, 591 P.2d 697, 699 (Okla. 1979).
[54] *Alta Mesa*, 613 B.R. at 106.
[55] *See id.*
[56] *Id*. at 107.
[57] *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 860 (Bankr. D. Colo. 2019)
[58] *Id*. at 874–75.
[59] *Id*. at 864.

> all interests in any wells, whether now existing or drilled hereafter, on, or completed on, lands covered by a Lease or within the AMI.[60]

The Colorado bankruptcy court held the dedications were covenants running with the land under Utah law.[61]

(A) Touch and Concern

In analyzing the touch-and-concern requirement, the court found "[t]he burdens imposed under the Agreements directly affect [Badlands'] use and enjoyment of its interests in the Leases in the AMI."[62] "The question is not what is conveyed by the covenant, but viewed in the context of its purpose, does the performance or nonperformance of it affect the use, value or enjoyment of the land itself."[63] The court looked at the purpose of the agreements—to compensate Monarch for the burdens associated with acquiring and operating the gathering system, which was connected

[60] *Id.*at 865.

[61] As recognized by the *Badlands* court, "the Utah Supreme Court recognized a broad test for touch-and-concern that does not require a physical effect upon the land but rather, requires a court to evaluate whether a covenant 'enhances the land's value [on the benefit side], and for the burden side, whether it diminishes the land's value.'" *Id*. at 868 (*quoting Flying Diamond Oil Corp. v. Newton Sheep Co.*, 776 P.2d 618, 624 (Utah 1989)). "[*A]ll that must be shown* for a covenant to run with the land is that it 'be of such character that its performance or nonperformance will so affect the use, value or enjoyment of the land itself that it must be regarded as an integral part of the property.'" *Flying Diamond*, 776 P.2d at 624 (emphasis added).

While the definition of touch and concern is practically identical in Texas and Utah, the Utah Supreme Court has applied the standard more broadly. In *Flying Diamond*, mineral owner promised to pay 2.5% of its production to its surface owner in exchange for surface owner's conveyance of broad easements on the land overlying the mineral interests to allow the mineral owner to carry on oil and gas exploration and production. *Id.* at 620–21. The agreement was binding on successors, but the parties agreed the surface owner had no rights in the mineral estate. *Id.* at 620. The successor mineral owner sued to enforce the covenant, and while the covenant appeared to be personal, the Utah Supreme Court held that the covenant "must be viewed in light of the other provisions of the Agreement, which create various easements and surface rights in favor of [mineral owner]." *Id.* at 625. When viewed in the context of its purpose, the payment covenant compensated the surface owner for the burdens imposed on its surface operations, and thus, ran with the land. *Id.*

The Wyoming Supreme Court has found the *Flying Diamond* analysis "instructive" when determining whether a covenant runs with the land under Wyoming law. *Jacobs Ranch Coal Co. v. Thunder Basin Coal Co., LLC*, 191 P.3d 125, 130 (Wyo. 2008). But, as noted by Judge Owens, the Wyoming Supreme Court "stopped short of adopting any of the [Utah Supreme Court]'s touch and concern analysis." *In re Southland Royalty Co. LLC*, 623 B.R. 64, 85 (Bankr. D. Del. 2020).

[62] *Badlands*, 608 B.R. at 868.

[63] *Id.* at 869.

to Badlands' wells located on the leases via receipt points—and concluded the touch-and-concern requirement was satisfied.[64]

The court was not persuaded by Wapiti's argument that the touch and concern standard was not satisfied because the agreements' objective was the gathering, processing and disposal of produced gas and water, which are not real property interests under Utah law. The court rejected Wapiti's argument, finding that it mistakenly focused on operations—"the tasks to be undertaken to satisfy the benefits and burdens that flow both ways with respect to their real property interests"—not the underlying purpose of the agreements, which was key to determining whether the covenant satisfied touch and concern.[65]

(B) Privity

Additionally, *Badlands* contains a lengthy and instructive privity discussion and sets out three different types of privity—vertical, mutual, and horizontal privity—which have been applied singly and in combination.[66] The court focused its discussion on mutual privity and horizontal privity, first describing mutual privity as a "continuing and simultaneous interest in the same property."[67] Horizontal privity, which is distinct from mutual privity, exists when "the original covenanting parties create a covenant in connection with a simultaneous conveyance of an estate."[68] Although the Utah Supreme Court has strongly criticized both horizontal and mutual privity, the *Badlands* court separately analyzed both and found that, whether required or not, Monarch's arrangement with Badlands satisfied both horizontal and mutual privity.[69]

Specific to mutual privity, the *Badlands* court analyzed whether Monarch and Badlands held a continuing and simultaneous interest in the same property and found mutual privity was satisfied for two reasons.[70] First, Monarch owned the gas and produced water gathering systems and easements on the same land in which Badlands owned oil and gas leases, thus creating

[64] *Id.* at 868–69.

[65] *Id.*at 869.

[66] *Id.* at 871–73.

[67] *Id.* at 871.

[68] *Id.*

[69] *Id.* at 872–73 (citing *Flying Diamond Oil Corp. v. Newton Sheep Co.*, 776 P.2d 618, 628–29 (Utah 1989)).

[70] *Id.* at 873.

simultaneous ownership in the same property.[71] Second, the court examined the dedication language, which was a dedication of Badlands' reserves and found, "[a]lthough Monarch does not have a fee estate to the Dedicated Reserves, the Dedication is based upon an interest Monarch has in land … [and] [a]ccordingly, mutual privity is satisfied."[72]

The *Badlands* court likewise found that horizontal privity was satisfied for two reasons.[73] First, the dedications were made in connection with the conveyance from Badlands to Monarch of the gathering and saltwater disposal systems.[74] And further, the agreement contained a conveyance of a floating easement across Badlands' oil and gas leases and lands covered thereby.[75] Wapiti argued the easement granted in the agreement, as in *Sabine*, was not a conveyance satisfying horizontal privity because it burdened only the "related" surface estate—not the same mineral estate burdened by the dedication. The court disagreed and distinguished *Sabine*.[76] Unlike *Sabine*, the covenants at issue burdened Badlands' real property interests (the Dedicated Reserves and the leases) in the context of a simultaneous conveyance of real property interests (the gathering and saltwater disposal systems) to Monarch, both of which are located in the same geographic area. The conveyances of the gathering system and floating easement were both held to satisfy horizontal privity.[77]

Thus, in short, the *Badlands* and *Alta Mesa* courts held that a midstream agreement did constitute a covenant running with the land under Utah and Oklahoma law, respectively, and could not be rejected.[78]

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[71] *Id.*
[72] *Id.*
[73] *Id.* at 873–74.
[74] *Id.* at 873.
[75] *Id.*
[76] *Id*. at 874.
[77] *Id.*
[78] *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 875 (Bankr. D. Colo. 2019); *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 107 (Bankr. S.D. Tex. 2019).

IV. UPSTREAM APPROACH: *SABINE*, *EXTRACTION* AND *SOUTHLAND*.

Contrary to the Midstream Approach, the Upstream Approach views midstream agreements as mere service contracts for the transportation of personal property—produced oil or gas. The focus has centered on whether the midstream agreement requires the underlying mineral estate be put to a specific use. Although exceptions exist, the standard midstream agreement generally does not require drilling, and the midstream counterparty also frequently waives any right to control how existing wells are produced. Therefore, midstream agreements fail to form a covenant running with the land or equitable servitude under the Upstream Approach because standard dedications do not "touch and concern" real property.

Furthermore, courts utilizing the Upstream Approach appear reluctant to find standard midstream agreement provisions—the floating easement conveyance, for example—satisfy privity of estate. The Upstream Approach focuses on whether the producer conveyed an interest in the underlying mineral estate, rather than the surface estate, to the midstream counterparty. Although the floating easement may be part of the lessee's leasehold estate, the Upstream Approach has considered this a surface interest conveyance because no access to the mineral estate is conveyed. Actual mineral conveyances, in the form of an overriding royalty interest or some other interest, are uncommon in midstream agreements. As a result, the midstream dedication fails to form a covenant running with the land even if it touches and concerns real property. The three cases applying the Upstream Approach are *Sabine*, *Extraction*, and *Southland*, all of which held certain midstream agreements failed to qualify as covenants running with the land, and therefore, were subject to rejection.

1. *Sabine*.

In *Sabine*, decided under Texas law, two midstream companies, Nordheim Eagle Ford Gathering, LLC and HPIP Gonzales Holdings, LLC, argued their respective agreements with debtor Sabine were covenants running with the land that could not be rejected in bankruptcy. The Bankruptcy Court disagreed, and the *Sabine* opinion was affirmed by the United States District

Court for the Southern District of New York court and the United States Court of Appeals, Second Circuit.[79]

The Nordheim agreement provided that:

> Shipper has dedicated for gathering and dehydration, and has agreed to deliver or cause to be delivered to Gatherer at the Receipt Points … all Gas produced and saved on or after the Effective Date from wells now or hereafter located within the Dedicated Area or on lands pooled or unitized therewith.

The HPIP agreement provided that "Producer hereby dedicates and commits to the performance of this Agreement the Leases and all of Producer's owned or controlled Production produced and saved from Producer's operated Wells located on the Leases." Both the Nordheim and HPIP agreements explicitly provided that the parties intended for the dedication to run with the land. Nevertheless, Sabine sought to reject the agreements. The Bankruptcy Court focused its analysis on two elements: (1) touch and concern and (2) horizontal privity.

(A) Touch and Concern

HPIP and Nordheim failed to establish their midstream agreements touched and concerned the land. The Bankruptcy Court recognized two tests for determining whether touch and concern is satisfied under Texas law. The first test considers whether the covenant "affected the nature, quality or value of the thing demised, independently of collateral circumstances, or if it affected the mode of enjoying it."[80] The second test evaluates whether "the promisor's legal relations in respect of the land in question are lessened—his legal interest as owner rendered less valuable by the promise … [and] if the promisee's legal relations in respect to the land are increased—his legal interest as owner rendered more valuable by the promise."[81] The Bankruptcy Court held the covenants at issue did not satisfy either test: "they do no impact the value of the land 'independent of collateral circumstances' and do not affect any interest in the real property of, or its use by, the

[79] The Second Circuit opinion is not precedential in nature, as it was issued as a "summary order." Even within the Second Circuit, such orders are not considered binding precedent. Courts can still, however, look at it for its persuasive value.

[80] *In re Sabine Oil & Gas Corp.*, 550 B.R. 59, 80 (Bankr. S.D.N.Y. 2016), *aff'd*, 567 B.R. 869 (S.D.N.Y. 2017), *aff'd*, 734 F. App'x 64 (2d Cir. 2018) (citing *In re El Paso Refinery*, 302 F.3d 343, 356 (5th Cir. 2013)).

[81] *Id.* (citing *Westland Oil Dev't Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 911 (Tex. 1982)).

owner. Rather, those covenants constitute an undertaking personal to the producer (Sabine) and the midstream service providers (Nordheim and HPIP)."[82]

The Bankruptcy Court focused on the fact that the dedication covenants were triggered by the receipt of produced gas from Sabine into Nordheim and HPIP's facilities. Because the covenants were not triggered until after the gas had been severed from the mineral estate, the land itself remained unburdened.[83] Both the HPIP dedication and Nordheim dedication reference gas "produced and saved." HPIP and Nordheim drew the analogy to similar language that resulted in the creation of a royalty interest, which is a real property interest under Texas law, arguing Sabine's dedication of minerals "produced and saved" was a dedication of minerals in place, and thus, the dedication touched and concerned real property. However, the Bankruptcy Court did not agree that burdening oil and gas "produced and saved" burdens oil and gas still in the ground. "Texas law does not hold that *all* rights and obligations related to minerals yet to be produced necessarily create rights and obligations relating to real property. By the plain terms of the [agreements], the mineral dedications concern only minerals extracted from the ground, which indisputably constitute personal property, not real property, under Texas law."[84] The Bankruptcy Court recognized that as much as HPIP and Nordheim tried to argue otherwise, the obligations arising under the agreement were triggered by the gatherer's receipt of gas, not by the extraction of gas from the ground. As a result, the dedications did not run with the land.[85]

The Bankruptcy Court also was not convinced the HPIP dedication language, which expressly dedicated Sabine's leases to the performance of the midstream agreement, touched and concerned the land. The Bankruptcy Court held that such dedication was only "in furtherance of the overarching purpose of the contract, which is to provide product services to the Debtors."[86] "[T]he dedication does not constitute a burdening of [Sabine's] property interest, but rather an identification of what property and products are the subject of the Agreement and will be made

[82] *Id.* at 81.
[83] *Id.* at 82.
[84] *Id.*
[85] *Id.* at 67.
[86] *Id.* at 81.

available to the gatherer in furtherance of the purpose of the Agreements."[87] The Bankruptcy Court cited no authority for this proposition.

The District Court recognized the dedication of leases to the agreement did not implicate or otherwise burden the leases because Sabine clearly disclaimed any intent to convey title to the leases to HPIP in the agreements.[88] HPIP clarified that it was not asserting Sabine conveyed title to the leases themselves, but rather Sabine conveyed HPIP some lesser real property interest. However, the District Court was unable to conclude that HPIP's legal interest in the leases did in fact increase by virtue of the dedication language.[89] As a result, the agreements did not increase HPIP's real property interest, but rather granted HPIP the mere contractual right to be the exclusive provider of certain services for gas produced in certain areas.[90] The Bankruptcy Court therefore held that the dedications did not touch and concern the land.[91]

(B) Privity of Estate

Nordheim and HPIP also argued that horizontal privity was no longer a requirement for a covenant to run with the land under Texas law. However, the Bankruptcy Court (and the District Court and Second Circuit) were unwilling to bypass horizontal privity absent an explicit pronouncement otherwise from the Texas Supreme Court. Neither the Nordheim agreement nor the HPIP agreement were contained in a conveyance of real property. As a result, the Bankruptcy Court held that horizontal privity was not satisfied.[92]

The Bankruptcy Court rejected Nordheim's argument that the conveyance from Sabine to Nordheim of a pipeline easement and a parcel of land upon which Nordheim constructed a portion of its pipeline satisfied the horizontal privity requirement. Although these conveyances may have been related to the midstream agreement, "these facts do not fit within the traditional paradigm for horizontal privity of estate[, which] is the conveyance of an interest in property that itself is being

[87] *Id.*

[88] *HPIP Gonzales Holdings, LLC v. Sabine Oil & Gas Corp. (In re Sabine Oil & Gas Corp.)*, 567 B.R. 869, 875 (S.D.N.Y. 2017).

[89] *Id.* at 876.

[90] *Id.*

[91] *Id*. at 870. Nor did the midstream agreements constitute equitable servitudes. *Id.*

[92] *Sabine*, 550 B.R at 68.

burdened with the relevant covenant, not the conveyance of an interest in property that is distinct from (even if somewhat related to) the property burdened by the covenant."[93]

The Bankruptcy Court also rejected Nordheim's argument that horizontal privity was satisfied because Nordheim held a real property interest in the form of the right to take the minerals out of Sabine's mineral estate. The Bankruptcy Court described this as a mischaracterization of the midstream agreements, which only authorized Nordheim to take Sabine's gas from designated receipt or delivery points (personal property), not actually extract the minerals from the ground (real property). Because none of Nordheim's structures actually connected to Sabine's wells, Nordheim could not demonstrate the existence of a real property interest in Sabine's mineral estate.[94]

HPIP made a similar argument that it held a real property interest by virtue of the dedication language itself, which constituted a conveyance of real property by Sabine. The Bankruptcy Court described this as circular reasoning and recognized that HPIP's argument ignored Texas law that requires a conveyance of real property to have specific granting language, which HPIP's agreement lacked. Moreover, the HPIP agreement contained an express disclaimer that no rights or interests in Sabine's mineral estate were transferred to HPIP pursuant to the agreement. As a result, without concluding whether or not horizontal privity was a requirement under Texas law, the Bankruptcy Court held that horizontal privity did not exist between Sabine and Nordheim or Sabine and HPIP.[95]

Absent a conveyance of an overriding royalty or similar interest, it may be difficult for any midstream counterparty to establish horizontal privity under the Texas "traditional paradigm" applied in *Sabine* because the "traditional paradigm" requires a conveyance of the fee mineral estate.

[93] *Id.* at 68–69.

[94] *Id.* at 69–70.

[95] *Id.* at 70.

2. *Extraction*.

In *Extraction*, decided under Colorado law, the producer sought to reject three of its midstream agreements.[96] The dedication in the gas agreement provided that the producer "commits and dedicates the Dedicated Interests (whether now owned or hereafter acquired) and the exclusive right to receive from Producer and its Affiliates at the Delivery Points all Gas therein and thereunder and as may be produced therefrom to the performance of this Agreement."[97] This dedication was made subject to certain reservations, including the producer's right to "pool, communitize or unitize all or part of the Dedicated Interests with other lands, leases and properties," and importantly,

> "the right to operate the Dedicated Interests as Producer and its Affiliates deem advisable in their sole discretion, including the right, but never the obligation, to drill new wells, to repair and rework wells, to temporarily shut in wells, to renew or extend, in whole or in part, any oil and gas lease covering any of the Dedicated Interests, and to cease production from or abandon any well or surrender any such oil and gas lease, in whole or in part."[98]

Furthermore, the agreement specifically provided that only certain covenants would run with the land and be binding upon successors and assigns:

> "The Dedication and the Delivery Obligation, the grant of servitude hereinafter provided and other Property Rights and Producer's covenants under Section 2.3, together with all other related commitments in this Agreement and the matters set forth in GTC Section XV(a), GTC Section XV(b) and GTC Section XV(c) are not merely contract rights but are covenants running with (and touching and concerning) all of the Dedicated Interests (including the underlying Gas, lands, leases and wells) and, in addition, are binding upon the successors and assigns of [the] Dedicated Interests…"[99]

Additionally, the agreement defined "Dedicated Interests" as now owned or after-acquired "interests … in lands, mineral interests, easements, leases, wells and Gas therein and thereunder…"[100] The agreement also granted "a non-exclusive easement and right of way upon all lands covered by the Dedicated Area for the purpose of constructing, operating, repairing,

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[96] *Extraction Oil & Gas, Incorporated v. Elevation Midstream, LLC (In re Extraction)*, 2020 Bankr. LEXIS 2855, Adv. Proc. No. 20-50839, at *2–3 (Bankr. D. Del. Oct. 14, 2020).
[97] *Id*. at *7–8.
[98] *Id*. at *9.
[99] *Id*. at *9–10.
[100] *Id*. at *13–14.

replacing, maintaining, and removing measurement facilities for the Delivery Points."[101] The oil and water agreements contained similar provisions as to dedication of interests, reservation of certain rights, limitations as to which provisions would run with the land and conveyances of easements.[102] At issue was whether the elements of intent, horizontal privity, and touch and concern were satisfied so as to characterize the midstream agreements as covenants running with the land.

(A) Intent

The court first found that because the agreements expressly stated that certain covenants were to run, the parties only intended that those covenants run.[103] Thus, the only covenants capable of running with the land were those specifically identified and other "covenants" could not run.[104]

(B) Horizontal Privity

Concluding that horizontal privity was still required under Colorado law for a covenant to run with the land, the court examined whether such privity was demonstrated by Extraction's grant of easements to Elevation and by the dedication of oil and gas in place.[105] The court found that neither satisfied the privity requirement.[106]

The court reasoned that because the easements granted were only related to the surface estate and were personal rights in the use of that estate (*i.e.*, easements-in-gross), such a conveyance could not satisfy the privity requirement for covenants affecting the mineral estate.[107] The court also found that Extraction lacked any ability to convey an easement appurtenant to the mineral estate by such language or its rights of ingress and egress because "easement[s] appurtenant … [are] incapable of existence separate and apart from the particular land to which it is annexed."[108]

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[101] *Id*. at *16.
[102] *Id*. at *26–37.
[103] *Id*. at *46–47.
[104] *See id*.
[105] *Id*. at *51.
[106] *Id*. at *56–57.
[107] *Id*.
[108] *Id*. at *57 (citing *Lewitz v. Porath Family Trust*, 36 P.3d 120, 122 (Colo. App. 2001)).

Relying on a Colorado appellate court's assertion that a "dedication" is not synonymous with a "conveyance", the court also rejected Elevation's argument that the dedication of "interests … in lands, mineral interests, easements, leases, wells and Gas therein" effected a transfer of a real property interest.[109] Rather, the dedication merely identified produced products within an area subject to contractual obligations.[110] Because the dedication was made subject to a reservation of the producer's right to operate the dedicated interests as producer deemed advisable in their sole discretion, the court concluded that the producer had retained its rights, title and interest in the dedicated interests, and thus no transfer of a real property interest occurred by the dedication.[111]

(C) Touch and Concern

Elevation argued (and Extraction agreed) that the agreements contained a drilling commitment that touched and concerned the land because it required Extraction to drill, complete and equip a defined number of wells in the dedicated area by the end of 2022.[112] The drilling commitment "alter[ed] the parties' legal relationship" with respect to Extraction's mineral estates and, thus touched and concerned the land because it imposed an affirmative duty on the producer to perform a physical act upon the lands.[113]

But, the court rejected Elevation's assertion that the entire contract touched and concerned the land.[114] Citing to *MidCities Metro* and *Shaffer v. George*, the court concluded that only covenants capable of running with the land (those that meet all three required elements) will run and all other covenants are personal and subject to rejection.[115] Thus, first turning to the dedication, the court found that the dedication of personal property interests (produced gas) simply identified those interests and did not closely relate to any real property interest.[116] Furthermore, the court found that the dedications did not limit the producer's right to use or enjoy its mineral estates, and therefore did not touch and concern them.[117] An indirect effect upon the mineral estate, such as an

[109] *Id*. at *59 (citing *Stagecoach Prop. Owners Ass'n v. Young's Ranch*, 658 P.2d 1378, 1381 (Colo. App. 1982)).
[110] *Id*. at *59.
[111] *Id*. at *58–59.
[112] *Id*. at *66.
[113] *Id*. at *69.
[114] *Id*. at *68.
[115] *Id*. (citing *MidCities Metro. Dist. No. 1 v. U.S. Bank Nat'l Ass'n*, 12-CV-03322-LTB, 2013 WL 3200088, at *1 (D. Colo. June 24, 2013) and *Shaffer v. George*, 171 P. 881, 882 (Colo. 1917)).
[116] *Id*. at *72.
[117] *Id*. at *76–77.

incidental increase in value, was also not enough under the "closely relates" standard applied by Colorado courts.[118]

Then, turning to other covenants contained in the agreements (such as delivery obligations assignment provisions, Elevation's obligation to construct and operate pipelines, fixed fee provisions, exclusivity covenants and easements and rights-of-way), the court applied a similar analysis and found that none touched and concerned the producer's mineral interests.[119] The court examined each covenant and determined they only affected personal property, or burdened real property Extraction did not own, or did not impose restrictions on the alienability of mineral interests, or limit Extraction's rights to produce from or develop minerals in its own discretion.[120] When contrasted against the drilling requirement—which affected, burdened, and restricted real property interests owned by Extraction—these additional covenants appear to fall short of touching and concerning the land as required under Colorado law.

Ultimately, although the parties intended that certain covenants run with the land, and although the drilling commitment did touch and concern the land, there was no privity and therefore, no covenants running with the land capable of surviving rejection.[121]

3. *Southland*.

In *Southland*, decided under Wyoming law, the producer (Southland) sought to reject its midstream agreement with Wamsutter, LLC that contained a "burdensome" minimum volume commitment and associated deficiency fees.[122] The midstream agreement contained a dedication in which "Shipper dedicate[d] to the performance of this Agreement the Dedicated Properties and Dedicated Gas," further providing that "[t]his Dedication shall be a covenant running with the land under applicable law and binding on the respective successors and assigns of the interests of

[118] *Id*. at *78.
[119] *Id*. at *81–95.
[120] *Id.*
[121] *Id*. at *96.
[122] *In re Southland Royalty Co. LLC, In re Southland Royalty Co. LLC*, 623 B.R. 64, 70 (Bankr. D. Del. 2020).

Shipper and its Affiliates in and to the Dedicated Properties and Dedicated Gas."[123] The court ultimately held that the agreement contained no real covenants, thus permitting rejection.[124]

(A) Intent

In analyzing the intent requirement, the court focused on the fact that although the dedication section provided that the "Dedication shall be a covenant running with the land," there were no "other provision[s] in the L63 Agreement [that] contain[] this or similar language."[125] The court further noted "the parties clearly knew how to make their intentions known with respect to which covenants they wanted to run with the land, and they did so unambiguously only for the … Dedication."[126] The court would not permit Wamsutter to "bootstrap the remaining terms" of the agreement to the one and only covenant where intent was clear.[127]

(B) Touch and Concern

In examining the touch-and-concern element, the *Southland* court looked at whether the covenants substantially affected the legal rights flowing from ownership of the land.[128] Although Wamsutter argued the Wyoming Supreme Court had adopted Utah law with respect to covenants running with the land (*i.e.*, that the element is satisfied if the covenant is "of such a character that its performance or nonperformance will so affect the use, value, or enjoyment of the land itself that it must be regarded as an integral part of the property"), the *Southland* court concluded that the Wyoming Supreme Court "stopped short of adopting any of the [Utah Supreme Court]'s touch and concern analysis."[129] The court found that because the dedication language did not convey any right, title or interest in the dedicated gas or dedicated properties to Wamsutter, Southland was free to decrease or cease further exploration, drilling and production with respect to its unproduced gas

[123] *Id*. at 74–75.
[124] *Id*. at 79–80.
[125] *Id*. at 81.
[126] *Id*. at 82.
[127] *Id*.
[128] *Id*. at 83.
[129] *Id*. at 85.

reserves.[130] The only property rights affected by the dedication were personal property rights—*i.e.*, produced gas.[131]

(C) Horizontal Privity

Wamsutter argued horizontal privity was established by virtue of the dedication, a floating easement granted in the agreement and easement agreements entered into between the parties alongside the midstream agreement.[132] Finding that per industry custom, a dedication is only a commitment of produced gas from specific acreage—*i.e.*, an exclusivity agreement—the court found the dedication conveyed no real property interest.[133] The court also found the easements only burdened surface lands and not the mineral interests subject to the dedication, and therefore, could not satisfy the privity element because there was no conveyance of the underlying mineral estate.[134]

In summary, the *Sabine*, *Extraction*, and *Southland* courts determined that certain midstream agreements did not constitute covenants running with the land because either (1) the requisite intent that the covenants at issue run with the land was not evidenced, (2) the covenants at issue did not touch and concern the debtors' leasehold estate, and/or (3) horizontal privity, to the extent it is a requirement under Texas, Colorado and Wyoming law, was not satisfied.[135]

V. MIDDLE GROUND APPROACH: *CHESAPEAKE*.

The Middle Ground Approach represents a potentially evolving alternative to the Upstream Approach and Midstream Approach, both of which are perceived (rightly or wrongly) to be a binary decision courts must make when choosing between upstream and midstream companies. The Middle Ground involves not a choice between upstream and midstream but rather a focused review based on the merits of the particular midstream agreement. The Middle Ground was seemingly utilized by Judge Jones in the *Chesapeake* opinion, which was decided under Texas

[130] *Id*. at 83–84.
[131] *Id*.
[132] *Id*. at 86.
[133] *Id*.
[134] *Id*. at 86–87.
[135] *Southland*, 623 B.R. at 87; *In re Chesapeake Energy Corp.*, 622 B.R. 274, 284 (Bankr. S.D. Tex. 2020); *In re Sabine Oil & Gas Corp.*, 550 B.R. 59, 65 (Bankr. S.D.N.Y. 2016); *Extraction Oil & Gas, Inc. v. Elevation Midstream, LLC (In re Extraction)*, 2020 Bankr. LEXIS 2855, Adv. Proc. No. 20-50839 at *96 (Bankr. D. Del. Oct. 14, 2020).

law. The court's primary focus was not on broad upstream or midstream focused concepts. Rather, the court was laser focused on the agreement itself, a NAESB form gas sales agreement containing a transaction confirmation in which the producer dedicated produced gas to the midstream counterparty.[136] In that regard, the dedication was different than the real property dedications in *Alta Mesa* and *Badlands*.[137]

In this case, Chesapeake sought to reject a midstream agreement with ETC Texas Pipeline.[138] In the agreement, Chesapeake "dedicate[d] for sale and delivery hereunder all of the Gas owned or controlled by Seller or an Affiliate of Seller that is produced from the oil and gas leases described in Exhibit 'C'…" and further agreed that it "shall not assign, transfer or convey an interest now owned or hereafter acquired (directly or indirectly) in the Dedicated Leases without expressly making same subject to [the agreement]" and that "Seller's dedication hereunder is a covenant running with the land."[139] This dedication was made subject to certain reservations by Chesapeake, including the right to use gas for development, the right to pool or unitize the Dedicated Leases, the right to separate gas using mechanical equipment.[140] Additionally, the reservations provided that "Seller shall conduct operations on the Dedicated Leases free of any control by Buyer…."[141]

(A) Intent

The court noted the agreement contained express language that the parties intended for Chesapeake's obligation to sell certain quantities of gas to run with the land.[142] But, the court reasoned, because (1) the relief for failure to sell such quantities was personal in nature (*i.e.*, a "formulaic monetary payment" rather than specific performance of Chesapeake's obligation to sell

[136] *See Chesapeake*, 622 B.R. at 277–79.
[137] *Compare id.* ("Seller dedicates for sale and delivery hereunder all of the Gas owned or controlled by Seller or an Affiliate of Seller that is produced from the oil and gas leases…") *with Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 96 (Bankr. S.D. Tex. 2019) ("Section 3.3 dedicates to Kingfisher 'all Interests within the Dedicated Area'") *and Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 864–65 (Bankr. D. Colo. 2019) ("Producer ... exclusively dedicates and commits to the performance of this agreement the Dedicated Reserves … [being] the interest of Producer in all Gas reserves in and under … the Leases …").
[138] *Chesapeake*, 622 B.R. at 276.
[139] *Id*. at 278.
[140] *Id*. at 278–79.
[141] *Id*. at 279.
[142] *Id*. at 282.

the gas), and (2) the parties agreed that the purchase agreement was a "forward contract" under the Bankruptcy code, the requisite intent to create a covenant running with the land was absent.[143]

(B) Touch and Concern

ETC argued the dedication of oil and gas produced from the leases touched and concerned the land, but "[n]otably, the Debtors did not assign a specific interest in the oil and gas leases themselves."[144] Similar to *Sabine*, because the covenants were not triggered until after the gas had been severed from the mineral estate, the covenant did not impact Chesapeake's ability to use and enjoy its real property rights.[145] As Judge Jones noted, "the parties' words matter" and here, Chesapeake dedicated produced gas rather than the leases themselves.[146] As a result, the dedication did not touch and concern real property because the producer dedicated only produced gas—a personal property interest.[147]

(C) Privity of Estate

The *Chesapeake* court did not opine on whether horizontal privity was required under Texas law.[148] However, Judge Jones ultimately found that privity of estate was not satisfied because there was no conveyance of an interest in real property at the time of the agreement's execution.[149]

ETC also argued the gas dedication combined with a dedication of "such property rights arising out of the Dedicated Leases necessary to burden the Dedication Leases with Chesapeake's dedication of the Dedicated Leases and Gas" sufficiently established horizontal privity.[150] But, the court was skeptical of this attempt to dedicate "whatever is necessary to make sure that the dedication was valid" and concluded that because the parties agreed the agreement was a "forward

[143] *Id*. at 279–80.
[144] *Id*. at 284.
[145] *Id*.
[146] *See id.*
[147] *Id*.
[148] *See id*.
[149] *See id*.
[150] *Id*. at 283.

contract" under § 101 of the Bankruptcy Code, the purpose of the agreement was to provide for the ongoing purchase and sale of *personal*—not real—property.[151]

VI. THE NEXT STEP: ARE MIDSTREAM AGREEMENTS THAT FORM COVENANTS RUNNING WITH THE LAND IMMUNE FROM REJECTION?

In *Alta Mesa* and *Badlands*, the rejection analysis ended with the determination that a midstream agreement constituted a covenant running with the land. However, the *Extraction* and *Southland* courts, despite finding that the relevant agreements did not form covenants running with the land, went on to hold that even if the agreements at issue formed real property interests, the producer debtors could nonetheless reject them.

In *Extraction*, Judge Sontchi held the debtor could reject its midstream agreements, even if they did constitute covenants running with the land (which they did not), because under Colorado law, covenants running with the land are creatures of contract.[152] Once rejected, this simply results in a breach, not a termination, of those contracts and any covenants contained therein.[153] The covenants remain intact post-rejection,[154] but are unenforceable against the debtor because the midstream parties' claims could be fully satisfied by the bankruptcy claims process. The midstream agreements at issue provided for money damages to remedy any breach, which were easily calculable—thus, all the midstream parties would be left with post-rejection was a general unsecured claim.[155] Because the midstream parties' claims could be fully satisfied in the bankruptcy, they could not enforce the covenants against any of the debtor's successors or assigns.[156] The covenant survives in name only – it has no impact upon the debtor, and the debtor can freely enter into new midstream agreements with new counterparties.[157]

In *Southland*, Judge Owens piggybacked off *Extraction* and arrived at the same conclusion—that a debtor may reject an executory contract that contains a real covenant.[158] Like

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[151] *Id*.
[152] *In re Extraction Oil & Gas*, 622 B.R. 608, 622 (Bankr. D. Del. 2020).
[153] *Id*.
[154] *Mission Prod. Holdings, Inc. v. Tempnology LLC*, 139 S. Ct. 1652, 1666 (2019) ("[W]e hold that under Section 365, a debtor's rejection of an executory contract in bankruptcy has the same effect as a breach outside bankruptcy. Such an act cannot rescind rights that the contract previously granted.").
[155] *Extraction*, 622 B.R. at 624–25.
[156] *Id*.
[157] *Id*. at *9.
[158] *In re Southland Royalty Co. LLC*, 623 B.R. 64, 88–89 (Bankr. D. Del. 2020).

Extraction, the court found that money damages stemming from the rejection and resulting breach would fully compensate the contract counterparty "and be consistent with the terms of the [contract] and state law."[159] However, the court went one step further and held that even if its rejection analysis were incorrect, any interests that the contract counterparty could enforce against a subsequent purchaser could be extinguished under section 363(f)(1) and (5), which allows for free and clear sales if otherwise allowable under state law or for which the counterparty could be forced to accept monetary satisfaction.[160] This is inconsistent with *Badlands*, which held that the debtor could not sell free and clear of a covenant running with the land because it is so integrally related to the underlying real property that it is part of the land itself.[161]

Judge Owens also examined whether the minimum volume commitment in the midstream agreement could be severed from the remainder of the contract as was argued by Southland.[162] Whether an agreement is indivisible or is several agreements in one is a matter of state law.[163] Under applicable state law, severability of the parts of a contract depend on the intent of the parties—which is evidenced by the interdependency and interconnectivity of various terms as well as whether the various terms can be struck without fundamentally altering the bargain the parties struck.[164] Judge Owens found that the terms of the midstream agreement (1) contemplated adjustments to the MVC if the gatherer was not required to construct all facilities originally contemplated by the parties, (2) contained a severability provision providing that the parties would attempt to negotiate reasonable replacement provisions in the event any single part of the agreement was found unenforceable, (3) contemplated an MVC that was so intertwined with the gathering and processing fee as to render them dependent.[165] The conclusion that the MVC was not severable was further bolstered by testimony from representatives of both parties as to the intertwined nature of fees under the agreement and its ties to the dedication—the dedication, the MVC and the fees were "a three-legged" stool without which the entire agreement would topple.[166]

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[159] *Id.*
[160] *Id.*
[161] *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 875 (Bankr. D. Colo. 2019).
[162] *Southland*, 623 B.R. at 89–92.
[163] *Id.* at *17 (citing *In re Buffets Holdings, Inc.*, 387 B.R. 115, 124 (Bankr. D. Del. 2008)).
[164] *Id.* at *17–18.
[165] *Id.* at *17.
[166] *Id.* at *18.

VII. DRAFTING CONSIDERATIONS.

In light of issues raised by the *Sabine*, *Extraction*, *Southland* and *Chesapeake* courts, practitioners tasked with ensuring a midstream agreement survives bankruptcy must take extreme care in drafting. Although difficult, there may be a narrow path to crafting a midstream agreement that survives even the most heightened scrutiny.

(A) Touch and Concern

There are two primary considerations when drafting to satisfy the touch and concern element. First, the dedication itself must encompass the producer's interest in the leases. However, good dedication language alone is likely insufficient to satisfy touch and concern under the most heightened standards. The midstream agreement therefore must also require the upstream counterparty to take some actions that physically impact the underlying mineral estate. There are two potential provisions that may accomplish such an objective, a drilling commitment and a covenant to not shut-in producing wells. Both provisions require the production of hydrocarbons and materially impact how the producer physically uses the mineral estate.[167]

The following is exemplar lease dedication language:

> Producer hereby exclusively dedicates to the services, this contract, the gathering system and gatherer, all of its interest in and to the oil and gas leases set forth on Exhibit "A" (the "Leases") and commits to deliver to the gathering system all gas owned or controlled by Producer which is produced from the Leases.

And following is a potential drilling commitment coupled with a no shut-in provision:

> Producer agrees to (i) drill and complete at least one Dedicated Well during the term of this Agreement and (ii) use commercially reasonable efforts to not shut-in any Dedicated Well(s) unless Producer reasonably concludes such Dedicated Well(s) has reached the end of its useful life or safety, technical or mechanical reasons necessitate shutting-in such Dedicated Well(s).

[167] The authors acknowledge commercial realities may make inclusion of drilling commitments and provisions restricting a lessee's right to operate wells difficult or impossible. However, absence of such provisions seemingly ensures an agreement won't satisfy the touch and concern standard employed by courts utilizing the Upstream Approach.

Although inclusion of these provisions does not guarantee a future court will find touch and concern is satisfied, absence of either a clear leasehold dedication or a provision that requires some production of hydrocarbons seemingly guarantees a court applying the heightened upstream standard will find touch and concern is lacking.

(B) Privity of Estate

Privity of estate presents a potentially difficult commercial obstacle for practicioners. Courts applying the heightened upstream standard have held implied lease easement conveyances do not satisfy horizontal privity.[168] And midstream companies are likely loathe to acquire a cost bearing leasehold interest. Therefore, the last resort for parties attempting to satisfy the most stringent privity standard may be inclusion of a *de minimis* overriding royalty interest conveyance from the producer to the midstream party. The overriding royalty is generally recognized as an interest in the mineral estate that is carved from the producer's leasehold estate.[169] And most producing states hold an overriding royalty is a real property interest.[170] Therefore, although the authors are not aware of any judicial decisions analyzing overriding royalty conveyances in midstream agreements, such a conveyance may satisfy even the most stringent privity standard. The overriding royalty interest seemingly avoids the implied lease easement's pitfall—being a right of access to the surface estate and not the mineral estate (even though carved out of the producer's leasehold estate).

The authors acknowledge very few midstream agreements contain an overriding royalty conveyance. This is likely a result of commercial realities such as accounting difficulty, impact on the producer's net revenue interest (even if minor) and industry custom. However, these obstacles

[168] *See* discussion *infra* Parts IV.1(B), IV.2(B), and IV.3(C).

[169] 5 Eugene O. Kuntz, *A Treatise on the Law of Oil and Gas* § 63.2 (Lexis 2020); John Lowe, Owen Anderson, Ernest Smith, David Pierce & Christopher Kulander, *Case and Materials on Oil and Gas* 177 (6th ed. 2012).

[170] *See* 5 Eugene O. Kuntz, *A Treatise on the Law of Oil and Gas* § 63.2 (Lexis 2020); *Page v. Fees-Krey, Inc.*, 617 P.2d 1188, 1194 (Colo. 1980) ("An overriding royalty carved out of the working interest in an oil and gas lease is an interest in real property."); *Team Bank v. Meridian Oil, Inc.*, 879 P.2d 779, 781 (N.M. 1994) ("an overriding interest is an interest in real property"); *Tennant v. Dunn*, 110 S.W.2d 53, 57 (Tex. App. 1937) (holding that royalties are interests in land); *Connaghan v. Eighty-Eight Oil Co.*, 750 P.2d 1321, 1324 (Wyo. 1988) ("We have long held an overriding royalty to be an interest in real property."); *but see Campbell v. Nako Corp.*, 402 P.2d 771, 775 (Kan. 1965) (holding that such interest is "personal property"); *Connell v. Kanwa Oil, Inc.*, 170 P.2d 631, 653 (Kan. 1946) ("an oil and gas lease conveys no interest in the land therein described but merely a license to explore, and is personal property"); *Barker v. Boyer*, 794 P.2d 322, 324 (Kan. Ct. App. 1990) ("such interest is not an interest in land but is personal property"); *See also* 1 Williams & Meyers, § 214.2 (Lexis 2020), for a discussion of seemingly inconsistent court decisions in Oklahoma with regard to the realty-personalty classification of non-operating interests.

may not be insurmountable as overriding royalty interests are routinely conveyed or reserved for other purposes.

Practitioners tasked with satisfying privity of estate should strongly consider inclusion of both an implied lease easement conveyance and an overriding royalty interest.

(C) Intent

Scant attention was paid to intent prior to recent decisions in *Chesapeake*, *Extraction* and *Southland*. Those decisions brought a couple of different issues into focus. First, the *Chesapeake* decision emphasized the need for specific performance of the parties' contractual obligations.[171] Therefore, practitioners would be well advised to include clear provisions permitting specific performance as a remedy. And *Chesapeake*, *Extraction* and *Southland* all highlighted the potential for an agreement to contain a covenant running with the land that is severable from the agreement's other commercial terms. To resolve this intent issue, midstream agreements should include provisions emphasizing the indivisible nature of the dedication and other commercial terms.

An exemplar specific performance provision follows:

> The Parties agree that monetary damages may not be an adequate remedy for a breach by Producer of its obligations under this Agreement. In the event of any such breach by Producer, the Gatherer, at its election, may seek specific performance of the Producer's obligations or other appropriate equitable relief.

Following is a potential intent provision:

> Producer and Gatherer represent and warrant that (i) this entire Agreement, including, without limitation, the Dedication, touch and concern the Dedicated Interests, (ii) this entire Agreement, including without limitation the ORRI conveyance, the Easement conveyance, and the Dedication, creates privity of estate between Producer and Gatherer, and (iii) the Parties intend for this entire Agreement, including, without limitation, the Dedication to be a covenant running with the land and equitable servitude binding upon the Producer and its successor in and to the Dedicated Interests.

Inclusion of the provisions described herein does not guarantee a future court will find the midstream agreement is a covenant running with the land. Nor is there any guarantee a future court will not severe a covenant running with the land from the rest of the agreement's commercial

[171] *In re Chesapeake Energy Corp.*, 622 B.R. 274, 282 (Bankr. S.D. Tex. 2020).

terms. However, the provisions and recommendations herein attempt to address through drafting all of the issues raised by every recent bankruptcy court decision on these issues and should afford those parties attempting to craft a bankruptcy-proof agreement the best chance to survive even the most heightened standards.