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Client Alert

Financial Restructuring Practice Group

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District Court Upholds Bankruptcy Court's Ruling on Rejection of Gathering Agreements

On March 10, 2017, the United States District Court for the Southern District of New York (the "Court") affirmed on appeal a bankruptcy court's prior decision in *In re Sabine Oil & Gas Corp.* that permitted a debtor to reject a midstream gathering agreement as an "executory contract."[1] The Court's decision, which is only the second decision nationally to address the rejection issue, firmly establishes a debtor's right to reject a midstream gathering agreement under certain circumstances.

Background

A summary of the decision of the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") from our prior Client Alert can be found here.

Following the Bankruptcy Court's oral ruling on March 8, 2016, Sabine Oil & Gas Corporation ("Sabine") and its co-debtors (collectively, the "Debtors") initiated adversary proceedings seeking declaratory judgments that the covenants contained in gathering agreements with Nordheim Eagle Ford Gathering, LLC ("Nordheim") and HPIP Gonzales Holdings, LLC ("HPIP") do not run with the land, and thus, the Debtors could reject the agreements. Nordheim and HPIP counterclaimed and sought opposite declaratory judgments. On May 11, 2016, the Bankruptcy Court granted summary judgment to the Debtors, sustaining its oral ruling that the Debtors could indeed reject the gathering agreements because the agreements did not contain covenants running with the land.

Nordheim and HPIP timely appealed. On March 10, 2017, Judge Jed Rakoff affirmed the Bankruptcy Court's decisions in the Nordheim and HPIP adversary proceedings, thus upholding the Debtors' decision to reject the gathering agreements.

The Decision

Notwithstanding that the agreements had language stating that they run with the land, the Court held that Nordheim's and HPIP's gathering agreements did not contain covenants running with the land. Accordingly, the Debtors could reject the Nordheim and HPIP gathering agreements.

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In so holding, the Court concluded that the agreements did not "touch and concern the land" because the agreements did not "affect the nature, quality or value of the things demised." Specifically, the Court stated, "Sabine's obligation under the agreements is simply to use Nordheim's and HPIP's respective gathering and processing services when it does produce and deliver gas and condensate, and that restriction does not limit Sabine's enjoyment of the land itself." Thus, the Nordheim and HPIP gathering agreements also did not constitute equitable servitudes.

The Court also factually distinguished the Fifth Circuit's decision in *In re Energytec, Inc.*[2] There, the Fifth Circuit determined that an agreement contained covenants that touched and concerned the land because prior owner had reserved to its subsidiary an interest that pertained to the use of the real property and affected the owner's interests in the pipeline.[3] Due to the factual distinctions, the Court found the *Energytec* reasoning inapplicable.

Conclusion and Potential Implications

The Court's decision in *Sabine* further cements a much maligned ruling that has negatively affected many midstream companies and caused further distress and disruption in the oil and gas industry. While much has been written about the Bankruptcy Court's decision and some bankruptcy judges have openly questioned its holding,[4] many similar disputes have been resolved through negotiation and settlement in other bankruptcy cases.[5] The Court's decision will continue to force midstream companies to renegotiate the terms of existing gathering agreements with bankrupt E&P companies and cause the same companies to modify the structures of their future transactions. It is important, however, to remember that a determination as to whether a gathering agreement can be rejected by a debtor in bankruptcy will require a fact-specific analysis that depends on the precise contractual language at issue and applicable state law.

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[1] Case No. 16-04127 (S.D.N.Y. Mar. 10, 2017).

[2] *In re Energytec, Inc.*, 739 F.3d 215 (5th Cir. 2013).

[3] *Id.* at 224.

[4] *See, e.g., In re Sandridge Energy, Inc.*, Case No. 16-32488 (Bankr. S.D. Tex. June 30, 2016) (Jones, J.).

[5] *See, e.g., In re Quicksilver Resources Inc.*, Case No. 15-10585 (Bankr. D. Del.) (settlement reached); *In re Penn Virginia Corp.*, Case No. 16-32395 (Bankr. E.D. Va.) (settlement reached); *In re Emerald Oil, Inc.*, Case No. 16-10704 (Bankr. D. Del.) (settlement reached); *In re Magnum Hunter Resources*, Case No. 15-12533 (Bankr. D. Del.) (agreements assumed); *In re SandRidge Energy, Inc.*, Case No. 16-32488 (Bankr. S.D. Tex.) (settlement reached); *but see In re Triangle USA Petroleum*, Case No. 16-11566 (MFW) (Bankr. D. Del.) (dispute proceeding in state court); *In re Tristream East Texas*, Case No. 16-31521 (DRJ) (Bankr. S.D. Tex.) (disputes ongoing).