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MIDSTREAM DEDICATIONS IN BANKRUPTCY: COLORADO COURT LEVELS THE PLAYING FIELD

by Lydia Webb, Jonathan Hyman, Jason Brookner and Rusty Tucker
October 15, 2019

In re Sabine Oil & Gas Corp., 550 B.R. 59, 65 (Bankr. S.D.N.Y. 2016) held that the gas gathering agreements under consideration were not covenants running with the land under Texas law and therefore could be rejected in bankruptcy as executory contacts. However, the United States Bankruptcy Court for the District of Colorado recently found that a gas gathering agreement and a salt water disposal agreement were both covenants running with the land under Utah law and could not be rejected or otherwise stripped from the underlying assets by a bankruptcy sale. *See Monarch Midstream, LLC v. Badlands Production Co., et al. (In re Badlands Energy, Inc.),* Adv. No. 17-01429-KHT (Bankr. D. Colo. Sept. 30, 2019) [Docket No. 61]. *Monarch* evens the score (so to speak) and provides midstream companies with compelling authority that agreements containing appropriate dedications of oil and gas reserves and that otherwise meet the relevant legal requirements should ride through bankruptcy unaffected.

BACKGROUND

Badlands Production Company, *et al.* ("Producers"), an E&P company, owned oil and gas assets in Utah (the "Riverbend Assets"). Producers sought to sell the Riverbend Assets in bankruptcy to Wapiti Utah ("Buyer") free and clear of all liens, claims and encumbrances. Monarch Midstream, LLC ("Monarch") was party to a gas gathering and processing agreement and a saltwater disposal agreement with Producers (the "Agreements"). Monarch objected to the sale of the Riverbend Assets free and clear of the Agreements, arguing they could not be rejected in bankruptcy because the dedications contained therein were covenants running with the land.

ANALYSIS

There are four requirements for a covenant to run with the land under Utah law: (i) it must touch and concern the land; (ii) the original parties must intend the covenant to run with the land; (iii) there must be privity of estate; and (iv) it must be in writing. These elements mirror the requirements under Texas law, and as with *Sabine*, the two elements at issue in *Monarch* were touch and concern and horizontal privity.

In Utah, to "touch and concern the land," the covenant must be of such a character that it affects the use, value or enjoyment of the land itself, to an extent it is regarded as an integral part of the property." The *Monarch* dedications satisfied the touch and concern element because the "burdens imposed under the Agreements directly affect the Producers' use and enjoyment of its interests in the Leases and AMI." The dedications burdened Producers' "interest … in all Gas reserves *in and under*, and … produced or delivered … " The "in and under" language affects minerals in the ground, which are real property interests under Utah law. The *Sabine* court held that a dedication of gas "produced and saved" failed to touch and concern real property because it constituted a personal property interest rather than an interest in real property.[1] Although Utah has a slightly broader definition of "touch and concern" than Texas, the *Monarch* court implied that a dedication of oil and gas reserves, leases and related lands would satisfy the touch and concern analysis under *Sabine*.

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[1] There were two different agreements at issue in *Sabine*, both of which had dedications pertaining to hydrocarbons "produced and saved" from dedicated wells and/or leases. That, as compared to the dedications at issue in *Monarch*, which cover "Dedicated Reserves" defined as "all Gas reserves in and under, and all Gas owned by Producer and produced or delivered from (i) the Leases and (ii) other lands within the AMI."

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The *Monarch* court also found that horizontal privity was satisfied. Horizontal privity exists under Utah law when the original parties "create a covenant in conjunction with a simultaneous conveyance of an estate." In the Agreements, Producers granted Monarch a right of way and easement across the leases and adjoining land for the purposes of installing and operating Monarch's gathering system. While this did not fit within the traditional paradigm for horizontal privity adopted by *Sabine*, the *Monarch* court held that Monarch's and Producers' simultaneous ownership of property interests on the same land satisfied privity to the extent it was a requirement under Utah law. In contrast, the *Sabine* court construed Texas law as requiring a "conveyance of an interest in property that itself is being burdened with the relevant covenant" to satisfy horizontal privity. Because horizontal privity only existed "with respect to property separate from the property burdened by the covenant at issue," horizontal privity did not exist in *Sabine*. The *Monarch* court held that to the extent the *Sabine* analysis applies, the dedication itself—although not a fee estate—constituted a conveyance that burdened Producers' real property interest (the leases and oil and gas reserves).

CONCLUSION

Because the Agreements were covenants running with the land, they could not be rejected by the Producers, and the Buyer could not acquire the Riverbend Assets free and clear of the Agreements. *Monarch* marks a significant departure from *Sabine* and arms midstream companies with additional arguments in the event their gathering and processing agreements face the prospect of rejection, or an attempted free and clear sale, in bankruptcy. The moral of the story is that the language used in any gathering and processing agreement matters, and will be the focal point of any dispute. The impact of *Sabine* and *Monarch* needs to be considered on the front end so that gathering and processing agreements are drafted to insulate the agreement in question to the greatest extent possible from a subsequent attack.

Gray Reed's Energy and Restructuring practices have extensively litigated these and similar issues in the chapter 11 cases of E&P companies like Quicksilver Resources and Vanguard Natural Resources. We are battle-tested, experienced and able to guide you through the uncertainties of the characterization and treatment of midstream agreements in bankruptcy. For more information, contact Jonathan Hyman (jhyman@grayreed.com) or Jason Brookner (jbrookner@grayreed.com).

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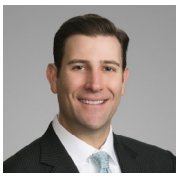

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