

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**

**Jonathan M. Hyman
Philip B. Jordan
Lydia R. Webb**

Gray Reed & McGraw LLP
1300 Post Oak Boulevard
Suite 2000
Houston, Texas 77056
713.986.7000

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/qaer-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/qaer_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

\$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>.

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: Update On Midstream Agreements in Bankruptcy—From Sabine to Southland and Beyond

Also available as part of the eCourse

[Answer Bar: Oil, Gas and Energy Agreements and Contracting Essentials](#)

First appeared as part of the conference materials for the

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

"Update On Midstream Agreements in Bankruptcy—From *Sabine* to *Southland* and Beyond"