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Blog Post

Distinguishing *Sabine*: *Badlands* and *Alta Mesa* Bankruptcy Court Decisions Have Implications for Midstream Oil and Gas

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In the 2016 bankruptcy case *In re Sabine Oil & Gas Corp.*[1], a New York bankruptcy court interpreting Texas law held that midstream gas gathering agreements did not create covenants running with the land and could therefore be rejected by the debtor during bankruptcy. *Sabine* had a transformational effect on the oil and gas industry. However, two recent court decisions, *Badlands*[2] and *Alta Mesa*[3], cut against the *Sabine* ruling and may significantly challenge and limit its applicability — with important implications for gas gathering agreements.

Overview

In the *Badlands* case, a Colorado bankruptcy court applying Utah law found that the gas gathering and processing agreement at issue in the case created real property covenants that could not be rejected. Similarly, in *Alta Mesa*, a Texas bankruptcy court recently ruled, applying Oklahoma law, that certain gathering agreements also created such real property covenants.

The legal requirements of a covenant running with the land vary slightly from state to state, but the dispositive attributes of the covenant were the same in each of *Badlands*, *Alta Mesa* and *Sabine*. Primarily, all three courts discussed whether (i) the burden or benefit of the agreement "touched and concerned" the land, (ii) there was privity of estate between the benefited party and the burdened party and (iii) the parties intended for a covenant that would run with the land. *Alta Mesa* and *Badlands* specifically distinguish *Sabine* on the requirements regarding touching and concerning the land and privity of estate. *Badlands* and *Alta Mesa* distinguished *Sabine* by explaining why certain required attributes of covenants running with the land were

found in the case under consideration despite the *Sabine* court's lack of finding in similar circumstances.

Badlands

The court in *Badlands* pointed primarily to the finding in *Sabine* that the interest conveyed by the gathering agreement did not "touch and concern" the land in distinguishing its findings. Explaining that interests as to minerals in place are considered real property interests, whereas extracted minerals constitute personal property, the *Badlands* court highlighted the differences between the dedications at issue in each case. By juxtaposing the "produced and saved" language in the dedication in *Sabine* with the "all Gas reserves in and under" language in the dedication before it, the court described how the *Sabine* court found that the dedication concerned personal property, an aspect of the gathering agreement that the Sabine court pointed to in its analysis finding that the interest did not "touch and concern" the land. However, the dedication in *Badlands* encompassed real property interest, the court explained, because of its inclusion of minerals in place.

The *Badlands* decision further distinguished *Sabine* in its assessment of the privity requirement of a covenant running with the land. The *Sabine* court held that, because the easement created by the agreement related only to the surface estate, the horizontal privity requirement was not met. Horizontal privity, the court said, requires the conveyance of an interest in the real property that is burdened with the covenant at the time of the creation of the covenant. Without openly rejecting the analysis in *Sabine* regarding Texas horizontal privity requirement, the *Badlands* court held that the requirement under Utah law is less stringent than that applied in *Sabine* and that, by conveying an easement over leases and through a dedicated area in the gathering agreement, the parties' ownership of property interests over the same land was sufficient to satisfy Utah's horizontal privity requirement. The court attributed the disparate outcomes to different legal requirements in the jurisdictions.

Alta Mesa

The court in *Alta Mesa* focused primarily on the distinction between fee simple mineral estates and leasehold interests to distinguish *Sabine*. The *Alta Mesa* court looked to the leasehold interest and its relation to the gathering agreement in its analysis of the "touch and concern" requirement; while the *Sabine* court pointed to the distinction between surface and mineral estates in holding that an agreement granting an

easement on the surface did not "touch and concern" the **mineral** estate (as it was simply a burden on the **surface** estate). The *Alta Mesa* court's focus on the leasehold estate was the court's basis for holding that the gathering agreement directly burdened and benefited the leasehold interest. The court contended that because the agreement created the easement by which produced minerals would be extracted, dedicated the leaseholder's production from the reserves, required recordation for subsequent transfers, and provided for fixed gathering fees that might diminish the value of the leaseholder's reserves, it, therefore, touched and concerned the land. Through its analysis of the same requirement as applied to a different type of interest, the court in *Alta Mesa* distinguished *Sabine* without explicitly rejecting the previous holding.

In distinguishing the *Sabine* finding that the parties lacked the requisite privity to create a covenant running with the land, the court used similar reasoning as the court in the *Badlands* case. While the *Sabine* court concluded that there was no horizontal privity because the easement was a real interest in the surface — and not the mineral — estate, the court in *Alta Mesa* again relied on the distinction between a leasehold estate and a fee simple mineral estate. The court held that the conveyance of the surface easements was enough to satisfy horizontal privity because a surface easement is a crucial component on an oil and gas lease and, therefore, the covenants at issue in the case were created with the conveyance of an interest in the leasehold estate.

Conclusion

While *Badlands* and *Alta Mesa* do not outright reject the *Sabine* decision, they significantly challenge and limit its applicability. Furthermore, this split in authority underscores how important language choice can be in drafting gathering agreements. Whereas *Sabine* might have given upstream producers guidance on how to tailor gathering agreements in ways that would be beneficial during a potential bankruptcy, through their enumerated divergences with *Sabine*, these two recent cases provide some direction to midstream companies who wish to strengthen the argument that gas gathering agreements constitute covenants running with the land that cannot be rejected by an upstream operator in bankruptcy.

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1. *Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC* (*In re Sabine Oil & Gas Corp.*), 550 B.R. 59 (Bankr. S.D.N.Y. 2016); aff'd, 567 B.R. 59 (Bankr. S.D.N.Y. 2016); aff'd, 567 B.R. 869 (S.D.N.Y. 2017); aff'd, 734 F.ed. Appx. 64 (2nd Cir. 2018).↩

2. *Monarch Midstream, LLC v. Badlands Production Co., f/k/a Gasco Production Co., Badlands Energy, Inc., f/k/a Gasco Energy, Inc., and Wapiti Utah, LLC, f/k/a Wapiti Newco, LLC* (*In re Badlands Energy, Inc.*), United States Bankruptcy Court for the District of Colorado, Adv. Proc. No. 17-01429-KHT↩

3. *Alta Mesa Holdings, LP v. Kingfisher Midstream*, LLC, No. 19-03609, slip op. at 1 (Bankr. S.D. Tex. Dec. 20, 2019)↩

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