

HOUSTON BANKRUPTCY COURT HOLDS MIDSTREAM GATHERING AGREEMENTS CANNOT BE REJECTED AS EXECUTORY CONTRACTS

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THE DISPUTE

On November 8, 2019, Alta Mesa Resources, Inc. ("Alta Mesa") and Kingfisher Midstream, LLC ("Kingfisher") crossed swords, each party filing dueling motions for summary judgment in the United States Bankruptcy Court for the Southern District of Texas. At issue is Alta Mesa's claim for declaratory judgment that the gathering agreements between the parties do not constitute covenants that run with the land pursuant to Oklahoma law and therefore may be rejected by Alta Mesa as an executory contract in bankruptcy. As discussed in greater detail below, the court's ruling underscores that questions surrounding this issue may vary by state and that it is incumbent on industry players to keep abreast of developments on point.

ALTA MESA'S ARGUMENT FOR CONTRACT REJECTION

Alta Mesa, like many oil and gas companies in bankruptcy court, sought to reject certain gathering agreements contending they are executory contracts "negotiated" by "conflicted" owners and managers, that create a "pervasive conflict of interest, imposing upon Alta Mesa gathering and processing fees that were and remain substantially above market." Or stated another way, Alta Mesa says it has the ability, based upon its business judgment, to reject the gathering agreements because they are unduly burdensome and rejection benefits the estate¹. To get there, Alta Mesa has to convince the court the agreements do not create a covenant running with the land pursuant to Oklahoma law. To create a covenant running with the land, Oklahoma requires: (1) privity of estate between the party claiming the benefit and the party carrying the burden, (2) that the covenant's burden or benefit touch and concern the land, and (3) that the original covenanting parties intended for the burden or benefit to pass to successors. Alta Mesa argues that Kingfisher cannot demonstrate either (1) horizontal privity between the parties or (2) that the covenant touches and concerns the land.

As Alta Mesa and Kingfisher are the original parties to the contract, Alta Mesa acknowledges vertical privity exists, but contends that no horizontal privity is present "because the covenant was not made in connection with the conveyance of a real property interest in Alta Mesa's mineral estate." Consequently, Alta Mesa asserts that Kingfisher fails to meet the element of horizontal privity. As for touching and concerning the land, Alta Mesa asserts that the covenant "has nothing to do with land and everything to do with extracted oil and gas." Thus, Alta

Mesa argues, the covenant does not touch and concern the land in any "real way"; rather, the covenant concerns mineral interests that Oklahoma law treats as personal property rather than real property.

KINGFISHER'S ARGUMENT THAT THE CONTRACTS ARE NOT EXECUTORY

Kingfisher, like most midstream companies, takes the position that not only are the gathering agreements covenants running with the land under Oklahoma law, but also that a theory of quasi-estoppel bars rejection by Alta Mesa. According to Kingfisher, Alta Mesa "previously took the position—explicitly and repeatedly—that [the gathering agreements] were covenants running with the land specifically to induce Kingfisher's reliance on such covenants." Thus, Kingfisher contends that Oklahoma law and the theory of quasi-estoppel prohibit Alta Mesa from engaging in such "gamesmanship," and that the Bankruptcy Code does not give a debtor a "free pass" to escape the unfavorable outcome of a properly negotiated transaction.

Specifically regarding covenants running with the land, Kingfisher sets out two reasons the gathering agreements touch and concern the land: (1) the agreements deal with minerals not yet reduced to possession at the time of the covenant and therefore involve interests in yet-to-be-developed minerals (as previously held under Oklahoma law); and (2) there is a logical connection between the benefit derived from enforcement of the covenant and the property. Like many midstream development companies, Kingfisher expressly developed this pipeline for the benefit of the oil and gas developer, in this case, Alta Mesa. As a result of the pipeline, the value of Alta Mesa's mineral assets were enhanced because the company enjoyed access to greater production value as a result of the Kingfisher pipeline development.

As an aside, Kingfisher also argues that Oklahoma law does not require horizontal privity for a contract running with the land. Nevertheless, Kingfisher argues that even if it did, the gathering agreements would satisfy the horizontal privity requirement because Alta Mesa conveyed interests in its mineral estate to Kingfisher in connection with the agreements, establishing horizontal privity.

COURT'S RULING

On December 6, 2019, following a brief telephonic hearing, Judge Marvin Isgur granted defendant Kingfisher's motion for summary judgment and denied Alta Mesa's competing motion for summary judgment regarding the gathering agreements. In so doing, the Court held that under the specific facts at issue, the gathering agreements are covenants that run with the land pursuant to Oklahoma law and, therefore, are not subject to rejection as executory contracts in bankruptcy proceedings.

Notably, this is the opposite result found in New York in the Sabine bankruptcy², wherein the District Court ruled that gathering contracts were executory and could be rejected. This New York court, however, found that the contracts were not covenants running with the land because they did not touch and concern the land under Texas law -- the court did not consider the question under Oklahoma law.

CONCLUSION

Both upstream oil and gas companies and midstream companies should take note of this ruling. The state laws related to covenants running with the land are not the same in every state and the factual background related to the negotiations and actual language found in various gathering agreements may not be identical. While a company's position may be similar in different bankruptcies, the determination as to whether gathering

agreements are executory in nature and subject to rejection may well depend on where the bankruptcy is pending and the breadth and depth of state law regarding covenants running with the land.

¹ See 11 U.S.C. § 365.

² *HPIP Gonzales Holdings LLC v. Sabine Oil & Gas Corp. (In re Sabine Oil & Gas Corp.)*, 567 B.R. 869 (S.D.N.Y. 2017)

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