

## Energy Restructuring Alert

February 5, 2016

### If you read one thing...

- On Tuesday, Judge Shelley Chapman, the Southern District of New York Bankruptcy Judge in the *Sabine Oil & Gas* chapter 11 cases, noted she was “inclined” to permit the rejection of certain gathering and processing agreements involving Texas oil and gas properties.
- Many midstream companies have taken comfort in acreage dedications being characterized as “covenants running with the land,” but these may not stand up in bankruptcy against potential rulings that the agreements are executory contracts subject to rejection.
- Permitting the rejection of gathering and processing agreements in bankruptcy may materially aid E&P companies in chapter 11 and creditor recoveries, but may not necessarily be a wholesale benefit to E&P companies vis-a-vis their midstream counterparties as there are practical considerations that may allow midstream companies to retain negotiating leverage.



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### Midstream Contract Acreage Dedications at Risk

After oral arguments Tuesday in the *Sabine Oil & Gas* chapter 11 cases, Judge Chapman noted that she was “inclined” to permit the rejection of Sabine’s gathering and processing agreements with two counterparties, potentially saving the company a significant sum either in ongoing payments or by avoiding a discount if its assets are sold.

Many midstream companies have long taken comfort in acreage dedications in midstream contracts being characterized as “covenants running with the land.” This has historically served as a protection against asset sales being made without the new owners being subject to the contracts. However, with the downturn in oil and gas prices, the full meaning of these dedications is being widely tested in bankruptcy cases.

While acreage dedications may be found to be covenants running with the land, in the bankruptcy context, the real underlying issue is whether the dedication is a real property interest in the hands of the midstream company under applicable state law. We believe that a ruling that a typical gathering agreement that includes an acreage dedication is an executory contract subject to rejection likely would be supportable under existing Texas law.

While these rejections may result in significant immediate savings to E&P companies, they will not necessarily be a wholesale benefit to E&P companies vis-a-vis their midstream counterparties. Other issues to address include the quantification of damages, impacts to property values and effects on other claimants, including lessors under oil and gas leases. Further, given the unique nature of many of these gathering and processing systems, it is likely the counterparties will still want to work together due to the critical need for cash flow on both sides. Contract renegotiations will turn on the leverage of the parties involved, particularly whether the E&P company can survive a shut-in (harming cash flow and potentially putting its oil and gas leases at risk) or has another way to move or process its hydrocarbons. Finally, it is likely that midstream companies and their financing partners will start to think about ways to mitigate this rejection risk on a going-forward basis via security requirements and contract structuring.

This will be an ongoing question in oil and gas bankruptcies that will turn on specific background facts, the language of each contract, applicable state law regarding property rights and covenants running with the land, and how the particular presiding court construes applicable precedent.

With our long and active history in energy and financial restructuring, coupled with our current role in the Sabine chapter 11 cases on behalf of the indenture trustee of the Sabine unsecured noteholders, we continue to monitor the situation and are working with a wide variety of industry, financing and investment fund clients generally to assess and address matters pertaining to gathering and processing agreement in bankruptcy. Please contact the following attorneys or your regular Akin Gump contact to discuss how acreage dedication and other restructuring issues may impact your existing or potential counterparty relationships or investments.

## Contact Information

If you have any questions regarding this alert, please contact:

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