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STRAUSS HAUER & FELD LLP

Energy Restructuring Alert

March 10, 2016

- On March 8, 2016, Judge Shelley Chapman, the Southern District of New York Bankruptcy Judge in the *Sabine Oil & Gas* chapter 11 cases, authorized the Sabine Debtors' rejection of certain of gathering and processing agreements involving Texas oil and gas properties.
- Judge Chapman demurred on procedural grounds from any final determination as to whether the acreage dedication and gathering fee covenants "run with the land" as argued by the counterparties, but made it clear in a nonbinding analysis that she believes that, in the case of the applicable contracts at issue, the covenants do not "run with the land" or involve real property interests under Texas law and therefore would be subject to rejection with the rest of the agreements.
- While the issue is not settled, Judge Chapman's ruling is likely to embolden exploration and production (E&P) companies seeking to reject or otherwise renegotiate gathering and processing agreements, increase talk of possible strategic bankruptcies and pose significant concerns for midstream companies during these turbulent times and in structuring agreements going forward.

Midstream Acreage Contract Dedications Take a Hit in Bankruptcy

In a hotly anticipated ruling on Tuesday, Judge Chapman followed on her prior pronouncement that she was "inclined" to permit the rejection of certain gathering and processing agreements in the *Sabine Oil & Gas* chapter 11 cases by ruling in favor of the Sabine Debtors' rejection motion.

After finding that Sabine Debtors' decision to reject the agreements was a reasonable exercise of business judgment and authorizing the rejection of the agreements, Judge Chapman turned to the arguments of the midstream providers that the contract dedications and commitments to pay gathering fees were covenants "running with the land" that should survive rejection and therefore effectively require the Sabine Debtors to renegotiate with the midstream providers.

Judge Chapman "reluctantly" found that, due to procedural considerations, she could not issue a binding ruling regarding whether the subject contracts created covenants running with the land or equitable servitudes. However, she did provide an extensive, nonbinding analysis of the issue under Texas law, preliminarily finding that the agreements lacked several elements necessary to create a covenant that

"runs with the land either as a real covenant or as an equitable servitude." As part of her analysis, Judge Chapman found, among other things, that there was no horizontal privity among the parties, no real property interest was transferred and the covenants do not concern the land or its use. The result of such a finding on a binding basis would mean that postrejection the Sabine Debtors would be free to negotiate gathering, processing and treating services with any party.

While the issue is far from settled, and each case will turn on specific facts and applicable state law, this ruling is likely to embolden E&P companies seeking to reject or otherwise renegotiate gathering and processing agreements, increase talk of possible strategic bankruptcies and pose significant concerns for midstream companies in E&P bankruptcies.

As discussed in our prior Energy Restructuring Alert, 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-á-vis their midstream counterparties. In evaluating the potential impact, there are various other legal and commercial issues to consider, including the quantification of damages, impacts to property values, shut-in risks, effects on other claimants (including lessors under oil and gas leases), the nature of the gathering system, practicalities of alternatives and the relative leverage of the parties in any renegotiation. Further, going forward, midstream companies and their financing partners are certain to be thinking of ways to mitigate potential future rejection risk as cases evolve, including via security requirements and contract structuring.

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 agreements in bankruptcy. Please contact the following lawyers or your regular Akin Gump Strauss Hauer & Feld LLP 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:

Sarah Link Schultz
Financial Restructuring
sschultz@akingump.com
214.969.4367
Dallas / Houston

Charles R. Gibbs
Financial Restructuring
cgibbs@akingump.com
713.250.2139
Dallas / Houston

Philip C. Dublin
Financial Restructuring
pdublin@akingump.com
212.872.8083
New York

Douglas Glass
Energy
dglass@akingump.com
713.250.2121
Houston

Stephen D. Davis
Energy
sddavis@akingump.com
713.220.5888
Houston

John Goodgame
Energy
jgoodgame@akingump.com
713.220.8144
Houston

Shubi Arora
Energy
sarora@akingump.com
713.220.5832
Houston

Jhett R. Nelson
Energy
jrnelson@akingump.com
713.220.8106
Houston