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Mitigating Rejection of Midstream Agreements in Bankruptcy

by David H. Sweeney, Jason P. Rubin, and Laura P. Warrick, Akin Gump Strauss Hauer & Feld, LLP, with Practical Law Oil & Gas

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An Article discussing recent bankruptcy case law rejecting midstream agreements containing covenants running with the land. This Article suggests practical solutions to mitigate rejection risk.

Producers of hydrocarbons generally require some level of gathering, processing, and other midstream services to monetize hydrocarbons. To ensure the performance of midstream contracts by producers, midstream service providers historically have included covenants running with the land in these contracts.

Holdings in recent bankruptcy cases have challenged the notion that contracts containing covenants running with the land are not rejectable in bankruptcy.

This Article examines the current legal state of play regarding covenants running with the land in bankruptcy court and offers practical suggestions for how producers and midstream providers might navigate this new reality, including:

- Conducting diligence to identify red flags and address potential issues before they become problems.
- Addressing the shortcomings of covenants running with the land noted by the bankruptcy courts.
- Replacing covenants running with the land with a substitute, such as a presently possessory interest or a lien.

Background

Importance of the Treatment of Midstream Agreements in Recent Oil & Gas Bankruptcies

Hydrocarbons in place are constrained by subsurface geological features. Once produced, they generally require the use of fixed oil and gas midstream facilities, such as gathering and transportation systems, tanks, and natural gas processing plants. These facilities are expensive and have capacity constraints. The construction, maintenance, and operation of midstream facilities require substantial capital outlay. Hydrocarbon producers generally obtain access to this midstream infrastructure through contracts with midstream service providers (the owners of this infrastructure). For more information on midstream services, see Practice Note, US Oil & Gas Industry: Overview: Oil & Gas Industry Segment: Midstream.

Midstream service providers frequently attempt to ensure expected returns from relationships with producers by tying contractual obligations to a producer's reserves. One common method of accomplishing this is to include in midstream contracts a clause dedicating the land or reserves to the midstream infrastructure. This dedication is intended to bind third parties, including estates in bankruptcy, by styling it as interests in real property (for example, reserves in place).

Under this arrangement, there are benefits to both:

- Midstream companies, which benefit by:
  - ensuring that the commercial deal stays with the reserves regardless of owner;
  - providing for infrastructure utilization and return on capital; and
  - rationalizing capacity allocation.
- Producers, which benefit by:
  - securing continued use of midstream infrastructure; and
  - gaining access to markets.

Without return/flow assurance, midstream companies might be reluctant to build infrastructure or commit capacity.

Many producers with burdensome midstream agreements containing covenants running with the land filed for Chapter 11 bankruptcy in recent years. Renegotiating or avoiding compliance with these agreements typically is a major focus of the bankruptcy. In these cases, the question of what rights and options a debtor has regarding those agreements becomes central to the restructurings.

Executory Contracts May Be Rejected in Bankruptcy

Section 365(a) of the Bankruptcy Code "enables the debtor (or its trustee), upon entering bankruptcy, to decide whether the contract is a good deal for the estate going forward" (*Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019)). The debtor can choose to assume the contract and fulfill its contractual obligations going forward. If the debtor does not want to assume the contract going forward, the debtor may "reject the contract, repudiating any further performance of its duties." (*Mission Product Holdings*, 139 S. Ct. at 1658.) The Bankruptcy Code allows a debtor to "'reject any executory contract'—meaning a contract that neither party has finished performing" (*Mission Product Holdings*, 139 S. Ct. at 1657 (quoting 11 U.S.C. § 365(a))). Rejection is a breach of that contract and excuses future performance of the debtor, but rights conveyed before rejection, which would ordinarily survive a breach of contract, remain in place (*Mission Product Holdings*, 139 S. Ct. at 1657-58).

Rejection of Midstream Agreements Containing Covenants Running with the Land

Until recently, it generally was presumed that if a midstream contract contained a valid covenant running with the land, the contract could not be rejected under section 365 of the Bankruptcy Code on the basis that the contract conveyed an interest in real property. However, the presumption that a covenant running with the land precludes rejection has begun to evolve. Recent court decisions have explained that a midstream contract can be rejected under section 365 even if it contains a covenant running with the land.

Following the US Supreme Court's decision in *Mission Product Holdings*, where the Court held in the context of a trademark licensing agreement that rejection of the contract does not deprive the licensee of its right to use a trademark post-rejection (139 S. Ct. at 1657-58), courts have held that executory contracts containing a covenant running with the land can be rejected but the real property interests conveyed before rejection remain conveyed (see *In re Sanchez Energy Corp.*, 2021 WL 1822708, at *8 (Bankr. S.D. Tex. May 6, 2021)). However, what it means to reject a contract while preserving the real property interest it conveyed is still being determined.

Requirements for a Covenant Running with the Land

The conceptual framework of a dedication is a commitment of specific lands and hydrocarbons in place and production from those lands to the contract. The dedication purports to provide a grant to a midstream provider of exclusive right to service or transport hydrocarbon production from those lands or interests.

The purpose of the dedication typically is to create an interest in real property, such as a covenant running with the land, that is "so connected to the underlying land that the benefit and burden pass to successors by operation of law" (*Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 99 (Bankr. S.D. Tex. 2019) (citing *Beattie v. State ex rel. Grand River Dam Auth.*, 41 P.3d 377, 386 (Okla. 2002) (Opala, J., concurring))). If a covenant runs with the land, it "inures to the benefit of, or must be fulfilled by, whatever party holds the land at the time when fulfillment is due" (*Southland Royalty Co. LLC v. Wamsutter LLC (In re Southland Royalty Co. LLC)*, 623 B.R. 64, 80 (Bankr. D. Del. 2020)).

The specific requirements of covenants running with the land vary from state to state (*Alta Mesa*, 613 B.R. at 99 ("When a dispute focuses on real property, the Court ordinarily applies the law of the state where the real property is situated.")). However, there are similarities between state laws (see, for example, *Alta Mesa*, 613 B.R. at 101 (noting that the elements to form a real property covenant in Oklahoma are identical to those in Utah and mirror those in Texas)).

As described by recent bankruptcy opinions in the context of contract rejection disputes, common requirements for a covenant to run with the land include:

- The parties must have intended that the covenant run with the land (see Parties' Intent).
- The benefit or burden must touch and concern the land (see Touch and Concern the Land).
- There must be privity of estate (including horizontal privity or vertical privity) (see Privity of Estate).

(See, for example, *Alta Mesa*, 613 B.R. at 99 (describing Oklahoma law); *Southland Royalty Co.*, 623 B.R. at 80 (describing Wyoming law); *Sanchez Energy Corp.*, 2021 WL 1822708, at *11 (describing Texas law); *In re Badlands Energy, Inc.*, 608 B.R. 854, 867 (Bankr. D. Colo. 2019) (describing Utah law).)

There typically are no magic words required to create a real property covenant. The analysis is more comprehensive, with the focus "on the intent of the covenanting parties." (*Alta Mesa*, 613 B.R. at 99 (internal citations omitted).)

Parties' Intent

Contract language expressly stating that the agreement contains "a covenant running with the land" suggests that there is an intent to bind successors and assigns, but that language on its own does not create a real covenant nor does it necessarily satisfy the intent element (*Alta Mesa*, 613 B.R. at 106). As noted in *Alta Mesa*, "[i]ntention should be determined by looking at the 'entire agreement construed as a whole'" (613 B.R. at 106 (citing *Baker v. Conoco Pipeline Co.*, 280 F. Supp. 2d 1285, 1298 (N.D. Okla. 2003))).

Factors reflecting intent include:

- Language in the agreement.
- Recording the agreement.
- Language binding successors and assigns.
- Extrinsic evidence relating to the parties' intent.

(*Alta Mesa*, 613 B.R. at 106.) Other provisions in a contract can contradict language expressing intent, showing the court that the contract is a "horse of a different color" (*In re Chesapeake Energy Corp.*, 622 B.R. 274, 282 (Bankr. S.D. Tex. 2020)). For example:

- If the contract provides for a monetary penalty as the exclusive remedy for a breach, "running with the land" language can be negated because the contract provides for an inherently personal remedy completely unrelated to any interest in real property.
- Language providing for specific performance as the exclusive remedy supports the idea that an agreement is a real covenant.
- If specific performance is one of many available remedies, a court is less likely to see the agreement as a real covenant or otherwise enforce specific performance.

(See *Southland Royalty Co.*, 623 B.R. at 80-82; *Chesapeake Energy Corp.*, 622 B.R. at 282.)

Touch and Concern the Land

The second key element in the covenant running with the land analysis is that an obligation purporting to bind successors must touch and concern the land. To satisfy this element, the covenant must closely relate to the land with which its use is intended (see *Extraction Oil & Gas, Inc. v. Platte River Midstream, LLC (In re Extraction Oil & Gas, Inc.)*, 622 B.R. 581, 598-603 (Bankr. D. Del. 2020); *Chesapeake Energy Corp.*, 622 B.R. at 282-83; *Southland Royalty Co.*, 623 B.R. at 83-86). The necessary touchstone is that there must be "a logical connection between the benefit to be derived from enforcement of the covenant and the property" (*Alta Mesa*, 613 B.R. at 102 (internal quotation omitted)). Whether this element is satisfied by midstream arrangements dedicating oil and gas is fact-intensive and may depend on the governing state law (*Alta Mesa*, 613 B.R. at 102). For example, in:

- *Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (In re Sabine Oil & Gas Corp.)*, the court found that there were three aspects of the gathering agreements that indicated that the agreements did not touch and concern real property. These three aspects were that:
  - "the debtor-producer retained the right to operate its wells without input from its gatherers";
  - the gatherer did not connect directly to the debtors' wells but instead at gathering system receipt points; and
  - the gathering fees were triggered by "the gatherers' receipt of hydrocarbons, not by the extraction of hydrocarbons from the ground."

  (*Alta Mesa*, 613 B.R. at 101 (describing *Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (In re Sabine Oil & Gas Corp.)*, 550 B.R. 59, 67 (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)).)
- *Badlands Energy*, the court found that the gathering agreements did touch and concern the land because "[t]he underlying objective of the agreements [is] to compensate for the burdens imposed by and upon the mineral and surface estates' property interests . . . for the production of natural gas" (*Alta Mesa*, 613 B.R. at 101 (quoting *Badlands Energy*, 608 B.R. at 868-69)). In addition, "Utah law called for a broad interpretation of the interests dedicated to the gatherer, which supported finding the formation of a real property covenant" (*Alta Mesa*, 613 B.R. at 101 (describing *Badlands Energy*, 608 B.R. at 869-70)).

- *Sanchez Energy Corp.*, the court found that certain agreements did touch and concern the land because they affected "the nature, quality, and value" of the leases at issue (2021 WL 1822708, at *12). The court considered the benefits and burdens on the mineral interests at issue, both produced and unproduced. It noted the increased value that stems from being linked to an accessible gathering system, the direct burden on the land by a granted surface easement, the dedication of substantially all the lessee's production burdening its right to build its own gathering system or seek alternative midstream arrangements, and the fixed fee gathering arrangement burdening the leasehold when market prices decreased (*Sanchez Energy Corp.*, 2021 WL 1822708, at *12). However, regarding a different contract (a development agreement) in the *Sanchez* opinion, the court noted that a drilling obligation touched and concerned the land but was "practically speaking . . . an option." That optionality, plus a monetary default fee, showed that the drilling agreement at issue did not form a real property covenant under Texas law. (2021 WL 1822708, at *15.)

Privity of Estate

Both vertical and horizontal privity traditionally were required for the burden of a covenant to run with the land.

Vertical Privity

Vertical privity means that there is a "mutual or successive relationship to the same rights of property" (*Sanchez Energy Corp.*, 2021 WL 1822708, at *13). This relationship arises when the person originally burdened or benefitted by the covenant transfers their estate to another. "An easy example of vertical privity is the transfer of a person's fee estate to another" (*Chesapeake Energy Corp.*, 622 B.R. at 283-84).

Horizontal Privity

Horizontal privity arises when a covenant is created in conjunction with a conveyance of a real property interest (*Alta Mesa*, 613 B.R. at 106). The historical purpose of this requirement was to ensure that covenants intended to run with the land were created in conveyances and help assure they were recorded to put subsequent owners on notice (*Sabine Oil & Gas Corp.*, 550 B.R. at 69). Some courts have found that conveyances of easements are sufficient to satisfy the privity element, but others have found that they are simply an interest in the surface estate and cannot satisfy privity of estate respecting a mineral estate.

Some recent decisions have cast doubt on whether the horizontal privity requirement still exists, but the law is unsettled on this point. For example:

- The court in *Alta Mesa* held that "[t]he surface easement is integrally tied to the purpose of an oil and gas lease, . . . [t]he conveyance of the easements to Kingfisher is enough to show horizontal privity with respect to the gathering agreements" (613 B.R. at 106).
- The *Badlands Energy* court similarly found that that the grant of a surface easement to a gatherer is a conveyance creating privity with an oil and gas lessee (608 B.R. at 874).
- The court in *Sanchez Energy Corp.* reached a similar result, holding that "[t]he Springfield Agreements . . . carved out a portion of Sanchez's implied surface easement and granted it to Springfield. . . . [which] conveyances of real property interests to Springfield are sufficient to satisfy horizontal privity." (2021 WL 1822708, at *14.)
- The court in *Extraction Oil & Gas* held instead that "an interest in the surface estate cannot qualify as a conveyance as an interest in Extraction's mineral estate as a matter of Colorado law. Conveyances of easements or rights-of-way across the surface estate are interests in the surface estate that cannot satisfy privity of estate respecting a mineral estate. . . . Because easements in gross are personal rights in the use of (and interests in) the surface estate, they are not interests in a severed mineral estate." (*Extraction Oil & Gas*, 622 B.R. at 607.) The *Sabine Oil & Gas Corp.* court reached a similar conclusion (*Sabine Oil & Gas Corp.*, 550 B.R. at 69).
- The Restatement (Third) of Property: Servitudes §§ 3.2 and 8.2 have abolished the doctrines of vertical privity and horizontal privity and the touch and concern requirement. It would call for the enforcement of a covenant if it is not contrary to public policy. However, to date, no state has officially adopted the Restatement's recommendations.

Rejection of Contracts Containing Covenants Running with the Land

In the context of a bankruptcy court considering a Chapter 11 debtor's effort to a reject a midstream contract, the issue that follows the analysis of whether an agreement contains a covenant running with the land is what that means for the debtor's ability to reject.

Until recently, the general understanding was that an agreement containing a covenant running with the land could not be rejected in a Chapter 11 proceeding under section 365 of the Bankruptcy Code (see, for example, *Sabine Oil & Gas Corp.*, 567 B.R. at 874, *aff'd*, 734 F. App'x 64 (stating that "it is not possible for a debtor to reject a covenant that 'runs with the land,' since such a covenant creates a property interest that is not extinguished through bankruptcy"); *Badlands Energy*, 608 B.R. at 875 (concluding that because the agreements were covenants that run with the land under Utah law, "Section 365 [was] simply not available")). However, that understanding is evolving.

Relying on *Mission Product Holdings* and its progeny, recent decisions from bankruptcy courts have held that any executory contract can be rejected even if it contains a covenant running with the land. For example:

- The *Sanchez Energy Corp.* court stated that "[a]lthough real property covenants are not terminated by rejection, the existence of a real property covenant does not prevent a debtor from rejecting its executory obligations in a contract" (2021 WL 1822708, at *8).
- The *Chesapeake Energy Corp.* court stated that "[i]t does not stretch the imagination to envision a contract that both contains a covenant that runs with the land and is executory" (622 B.R. at 281).
- The *Southland Royalty Co.* court stated that "[e]ven if, however, the [contract] contains a real covenant, the Court concludes that it may be rejected under section 365(a)" (623 B.R. at 80).

Even though courts may now allow rejection of an executory contract containing a covenant running with the land, if the covenant running with the land is valid and enforceable, the conveyed real property interests remain conveyed post-rejection. As stated in *Sanchez Energy Corp.*:

> "Real property covenants are clear examples of rights that are not terminated by a breach of contract. A given contract could convey countless other rights that might survive rejection consistent with *Mission Product*. The inquiry must be made on a case-by-case and contract-by-contract basis. Rejection of the [contracts] alleviates [the rejecting producer's] burdens under those contracts. Rejection does not strip [the midstream provider] of rights that would survive breaches outside of bankruptcy."

(2021 WL 1822708, at *9.)

In *Sanchez Energy Corp.*, the only case to date that has found both that a contract contained a covenant running with the land and that it could rejected under section 365 of the Bankruptcy Code, the court found that the rejecting producer could reject certain contracts but that previously conveyed property rights, such as the producer's dedications of its oil and gas and grants of surface easements, formed real property covenants that would survive rejection (2021 WL 1822708, at *22).

The *Sanchez Energy Corp.* court still found that rejection was a valid exercise of the debtor's business judgment because, in rejecting the contract, the debtor removed certain burdens and opened the door to renegotiation (2021 WL 1822708, at *22 ("The survival of those [real property] covenants does not negate Mesquite's business judgment. Rejection of the Springfield Agreements may still benefit the estate by removing some of Mesquite's burdens and opening the door to re-negotiation.")).

The 2020 *Extraction Oil & Gas*, *Southland Royalty Co.*, and *Chesapeake Energy Corp.* decisions addressed potential consequences of rejection of a contract containing a covenant running with the land but only in *dicta* because the courts determined that the contracts at issue did not contain valid covenants running with the land. In *Chesapeake Energy Corp.*, the court noted:

> "The appropriate analysis is what benefit was previously bestowed by the debtor on the non-rejecting party that remains post-rejection and what future performance by the debtor is excused by the rejection. . . . Depending on the particular language of the subject agreement, a plethora of outcomes are possible."

(622 B.R. at 281 (citing *Mission Product Holdings*, 139 S. Ct. at 1658).)

Providing more detail on the hypothetical were:

- *In re Extraction Oil & Gas*, where the court opined that even if the agreements contained covenants running with the land, the covenants would still exist after rejection but would be unenforceable and the claims would be reducible to money damages (622 B.R. 608, 623 (D. Del. 2020)). Once granted, this claim would be deemed "fully satisfied and incapable of subsequent enforcement against the Debtors and its assigns . . . ." If monetary damages are easily calculable, as the *Extraction Oil & Gas* court found that they were in that case, "specific performance is both unavailable and inappropriate." (*Extraction Oil & Gas*, 622 B.R. at 624.)
- *Southland Royalty Co.*, where the court reached a similar conclusion (623 B.R. at 89-90). It found that in a scenario in which the Debtor could reject the executory agreement and repudiate further performance, the midstream provider would have a prepetition claim for damages that would satisfy the purpose of the dedication. It further held that "continued enforcement of the [dedication] against a subsequent purchaser would thus be inequitable and against public policy." (*Southland Royalty Co.*, 623 B.R. at 90.)

Practical Suggestions

Both midstream providers and producers should consider these case law developments and evaluate how their contracts would be interpreted in a Chapter 11 rejection fight. Given the possibility that a contract containing a covenant running with the land may be rejected, midstream providers should consider seeking greater protection in their midstream agreements to receive priority if a producer counterparty files for Chapter 11 protection.

Diligence

Rejection of contracts, including midstream contracts, is a function of bankruptcy. The solutions discussed below are relevant only if the bankruptcy of a producer counterparty is a possibility. Dealing with a potential problem before it becomes an actual problem will likely put the parties in a better position than they would be in once solvency becomes an issue. From the perspective of:

- A midstream provider, a programmatic, ongoing risk analysis (potentially conducted regarding an adequate assurances clause found in many midstream agreements) would likely do more to reduce the overall exposure to insolvency risk than any other fix proposed in this Article.
- A producer, engaging with a midstream provider outside of the bankruptcy context presents an opportunity to revise a burdensome midstream agreement without the expense of bankruptcy or, if nothing else, lay the framework for a revision in bankruptcy.

A properly constituted review program should:

- Have ongoing, periodic, and event-driven triggers.
- Include options to address any identified issue that is specific to the assets and circumstances involved.

For example, drops in hydrocarbon prices or an increase in general services costs above predetermined thresholds could trigger a review.

However, permanent resolutions are likely to involve economic trades, such as reduced gathering fees and reduced or eliminated minimum volume commitments. Negotiations independent of a bankruptcy rejection process present unique arbitrage opportunities for midstream providers with multiple contracts with the same producer. Rights under one agreement may be sacrificed for new rights under a different agreement.

Fixed Covenants Running with the Land

Industry inertia and tradition would suggest that the most likely course of action for both the renegotiation of existing contracts and new midstream contracts would be to correct any deficiencies in existing covenants running with the land. Based on recent cases, it is not entirely clear whether and when bankruptcy courts will be inclined to find that a covenant running with the land exists (or, if it does exist, that the existence of a covenant running with the land precludes rejection under section 365 of the Bankruptcy Code). However, to directly address some of the shortcomings in the covenants involved in recent cases, a midstream provider seeking to reduce or eliminate the uncertainty of its covenant running with the land, should consider:

- **Language of intent.** The relevant provision should expressly state that it is intended to run with the land and bind successors and assigns. As evidenced by recent cases, this statement is important but not, by itself, sufficient because courts will look to the entirety of the contract to discern the parties' intent.
- **Recordation.** The relevant agreement or a memorandum thereof sufficient to impart notice to third parties of the existence of the agreement should be recorded in the real property records of the relevant county, parish, or recording district. In addition to the function of putting third parties on notice of the existing of the covenant, this evidences the parties' intent that the covenant be treated as running with the land.
- **Touch and Concern.** The midstream agreement and its burdens and restrictions should be tied as closely to the real property as practicable. While a gas purchase downstream at the wellhead may, depending on netted costs, be economically equivalent of gathering, it may be more difficult to make the claim that this contract runs with the land given recent holdings. Conversely, a true gathering contract where the gathering system connects directly to wells, with minimum volume commitments, development covenants and restrictions, deliverability tests, and similar features, would tie more closely to the real property involved and more likely meet the touch and concern element. Parties should consider omitting monetary penalties or liquidated damages because these could indicate that the parties did not truly intend the value of the contract to run with the land.
- **Privity.** While the continued requirement for horizontal privity is questionable, parties should still ensure that both horizontal and vertical privity tests are met. The

most certain way to accomplish this is through the conveyance of a presently possessory, non-easement interest in the relevant real property (see Presently Possessory Real Property Interest).

Industry practice historically has been reactionary in nature. From *Sabine Oil & Gas Corp.* forward, practitioners generally have rewritten covenants running with the land to address specific issues raised by a court. However, addressing recent case law developments may lead to creating so burdensome a contract that producers will be unwilling or unable to amend existing agreements or negotiate new agreements. Instead of reworking covenants running with the land to fit the changing legal framework, parties may consider other alternatives (see Presently Possessory Real Property Interest, Liens, and Clearly Articulated Rights and Remedies).

Presently Possessory Real Property Interest

Inclusion of a presently possessory real property interest would potentially provide protections where courts have found that contracts do not satisfy the elements of covenants running with the land. This interest could be cost bearing (such as a leasehold working interest), non-cost bearing (such as an overriding royalty interest), or synthetic-cost bearing (such as a net profits overriding royalty interest). In each case, the interest would be granted concurrently with and in consideration of the agreement of a midstream party to provide service. However, in each case, nothing would be payable by either party unless and until an amount is owed but not paid under the relevant midstream contract.

Using the example of an overriding royalty interest:

- The present language of grant would have the effect of conveying a percentage interest in hydrocarbons in place, free of the costs of production, to the midstream provider.
- The amount actually payable under this interest during any particular time period would be capped at a monetary amount equal to:
  - the producer's obligations under the midstream contract; or
  - what those obligations would have been absent the rejection of the midstream contract.
- If (and to the extent that) the producer continues to flow product through the midstream agreement and the midstream provider receives its fees, no amount is payable regarding the overriding royalty interest.
- If the contract is rejected or otherwise becomes unenforceable, the midstream provider would still be entitled to the amount that it would have received under its midstream agreement if production continued to flow from the encumbered property.

Practically, this could be carried out with common overriding royalty interest grants, with amounts that accrue to the benefit of the holder of the overriding royalty interest to be suspended, forgiven, or simply not paid unless, until, and only to the extent that amounts payable under the relevant midstream agreement are not paid.

In this case, the overriding royalty percentage would be a function of the amount of exposure and the risk of the interest ever being used. The effect would be that the midstream provider owns a presently possessory interest in reserves in place of the type that even courts that have declined to find covenants running with the land have not historically disturbed.

From a producer perspective, this would hypothetically cloud title but would be value-neutral in that it would never give its midstream counterparty more than the amount to which it would otherwise have been entitled. While credit agreements may prohibit the creation of these burdens, they may fall under divestiture baskets (given that the theoretical value of the burden is no greater than the related midstream contract) and general permitted encumbrances, and in any event, lenders may prefer this burden to a hypothetical fixed covenant running with the land.

Given the apparent posture of bankruptcy courts regarding midstream contracts generally, it remains to be seen whether courts would respect this construct. Because this interest in property would be non-operating, it would not protect a midstream provider from the implication in recent decisions that *Mission Product Holdings* would allow a producer to reject a midstream contract and simply abandon the burdened oil and gas properties. In this case, amounts would be owed under the midstream contract and would accrue to the real property interest granted to the midstream provider, but there would be no production to satisfy these amounts. However, this problem would be present regarding any of the potential solutions proposed in this Article.

Liens

Alternatively, producers could grant midstream providers liens in the property subject to the midstream contract. Liens securing performance are ubiquitous under joint operating agreements and frequently are permitted under credit agreements in the joint operating agreement context. In this respect, the implications of the refusal of a bankruptcy court to respect a lien securing performance under, for example, a gathering agreement would be profound. As with joint operating agreements, liens securing performance under a midstream contract would not secure any active indebtedness if obligations under the midstream contract were performed.

However, these liens are not a common construct in midstream contracts and likely would require approval under producer credit agreements. Producer's lenders may be less inclined to accept a lien relative to the presently possessory interest described above, even if this lien was subordinate to the lenders' liens. Conversely, from a midstream provider's perspective, a lien would be of questionable value given the procedural requirements to realize any value from the exercise of lien rights and the fact that any lien would likely be subordinate to lenders' liens.

Clearly Articulated Rights and Remedies

Under any scenario, parties should clearly articulate rights and remedies under the contract in the event of a breach. The agreement should provide for the right to compel specific performance and clearly articulate that monetary damages will not suffice for loss.

Conclusion

Midstream providers want to protect their investments, including by minimizing risks and consequences of contract rejection in bankruptcy court. The recent wave of case law on covenants running with the land and the ability of debtors in Chapter 11 to reject contracts containing them is disrupting one way in which midstream providers historically have sought to achieve that goal. In light of that reality, midstream companies should consider new ways to protect their investments, interests, and rights in a potential bankruptcy.