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## Rejection of Gathering Agreements in Bankruptcy Affirmed by Second Circuit in *Sabine Oil & Gas*

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On May 25, 2018, the United States Court of Appeals for the Second Circuit confirmed in *re Sabine Oil & Gas Corp.*<sup>1</sup> that a midstream gathering agreement did not create a real covenant that ran with the land,<sup>2</sup> and therefore, a debtor may reject the agreement as an “executory contract” under section 365 of the Bankruptcy Code.<sup>3</sup>

In making its determination, the Second Circuit focused on whether horizontal privity remained a part of the legal test in Texas for establishing a real covenant that runs with the land and, if so, whether horizontal privity was satisfied by the gathering agreement. The Second Circuit adopted the bankruptcy court’s analysis and concluded that horizontal privity remains a requirement under Texas law for a covenant to run with the land and that the requirement was not satisfied by the gathering agreement.<sup>4</sup>

The Second Circuit recognized that horizontal privity requires “a common interest in the land other than the purported covenant,” such as the conveyance of a fee interest in property.<sup>5</sup> Although the parties entered into separate agreements conveying a pipeline easement related to the applicable gathering system, the circuit court determined that the separate agreements were insufficient, as the land covered by the easements was different from the land burdened by the purported covenant.<sup>6</sup> Absent a common interest in the land, the gathering agreement did not establish horizontal privity of estate.<sup>7</sup>

The Second Circuit also concluded that a gathering agreement did not constitute an equitable servitude that could survive rejection under section 365 of the Bankruptcy Code.<sup>8</sup> Instead, it reasoned that the agreement benefited the midstream company as an entity and not the company’s real property. Additionally, it declined to consider whether the agreement “touches and concerns” the land because horizontal privity was not satisfied under Texas law.<sup>9</sup>

Although it is uncertain if the analysis in the *Sabine* decisions will be adopted on a national scale, midstream companies should take protective measures by revisiting their gathering agreements and improving their ability to establish horizontal privity and other elements reflecting interests that touch and concern the land. Holland & Hart LLP’s experienced oil and gas, corporate, and bankruptcy attorneys regularly work with clients on these and other issues impacting midstream companies.

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<sup>1</sup>*Sabine Oil & Gas Corp. v. Nordheim Eagle Ford Gathering, LLC (In re Sabine Oil & Gas Corp.)*, No. 17-1026, 2018 U.S. App. Lexis 13975 (2d Cir. May 25, 2018).

<sup>2</sup>*Id.* at \*8

<sup>3</sup>11 U.S.C. § 365(a).

<sup>4</sup>*Sabine Oil & Gas Corp.*, 2018 U.S. App. Lexis 13975, at \*5-7; *In re Sabine Oil & Gas Corp.*, 550 B.R. 59, 68 (Bankr. S.D.N.Y. 2016).

<sup>5</sup>*Id.* at \*4-5.

<sup>6</sup>*Id.* at \*6-7.

<sup>7</sup>*Id.* at \*7-8.

<sup>8</sup>*Id.* at \*9.

<sup>9</sup>*Id.* at \*4.