The 2016 Sabine ruling seemed to absolve E&Ps in bankruptcy from their midstream agreements, but a new Colorado case levels the playing field. The moral: Language matters.

Five years have passed since commodity prices cratered and the energy industry faced an onslaught of producer bankruptcies. For almost as long, producers and midstream companies have squared off over whether dedications in gathering and processing agreements are real property interests—and therefore immune from the reach of the bankruptcy court—or executory contracts that may be shed by a debtor through the restructuring process.

Until recently, the only ruling on the characterization of these dedications, Sabine, came down in favor of producers. However, a recent opinion in Badlands Energy by a Colorado bankruptcy court may have evened the playing field, providing midstream companies leverage in their negotiations with producers.

The financial implications of the characterization of dedications in gathering and processing agreements are huge. Over the past two decades, midstream companies have collectively invested billions of dollars in pipeline infrastructure in response to the domestic shale boom. Transportation and related fees charged to producers are structured to provide midstream companies a return of and on their investment over the life of the agreement.

The dedications contained in these agreements were intended to act as security for midstream companies (and their financiers), with the understanding that such dedications are real property interests and, therefore, binding on successors to the mineral interests.

The bankruptcy courts provide a unique forum for energy companies duking it out over the characterization of midstream dedications. Bankruptcy courts are federal courts that apply the laws of the state where the property is located to determine the parties’ relative rights. Given the popularity of Delaware and New York as “debtor friendly” filing venues, bankruptcy courts from these districts are often tasked with construing complicated and archaic property laws from states with significant oil and gas reserves, like Texas and North Dakota. These circumstances tend to favor producer-debtors over their midstream counter-parties.

The Sabine case, decided in 2016, is the prime example of how things can go wrong for a midstream company litigating the characterization of its dedications in bankruptcy court. Sabine sought to reject its gathering and processing contracts with Nordheim Eagle Ford Gathering and HPIP Gonzales Holdings in an attempt to make its assets more marketable and
The Badlands case arms midstream companies with additional arguments in the event their gathering and processing agreements face the prospect of rejection in bankruptcy.

Held midstream dedication did not constitute real property interest.

Dedication language: Producer dedicates to gatherer all gas “produced and saved” from wells located within the dedication area.

Privity could only be satisfied if the dedication was created in a conveyance of real property.

A Side-By-Side Comparison Of Sabine And Badlands

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\begin{array}{|l|l|}
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\text{Sabine (2016)} & \text{Badlands (2019)} \\
\hline
\text{Applied Texas property law.} & \text{Applied Utah property law.} \\
\text{Decided by New York bankruptcy court, affirmed by New York district court and Second Circuit.} & \text{Decided by Colorado bankruptcy court, was not appealed.} \\
\text{Held midstream dedication did not constitute real property interest.} & \text{Held midstream dedications constituted real property interests.} \\
\text{Dedication language: Producer dedicates to gatherer all gas “produced and saved” from wells located within the dedication area.} & \text{Dedication language: Producer dedicates to gatherer “gas reserves in and under … and produced or delivered from” the leases within the dedication area.} \\
\text{Privity could only be satisfied if the dedication was created in a conveyance of real property.} & \text{Grant of pipeline easement and right of way through dedication area was sufficient to establish privity.} \\
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Jonathan Hyman is a partner in Gray Reed’s Houston office. He has obtained successful verdicts, arbitration awards and settlements in a wide range of complex business litigation matters across Texas, the U.S. and abroad. In the midstream sector, Hyman handles every detail and phase of disputes involving midstream agreements. Lydia Webb is an associate in Gray Reed’s Dallas office. She focuses on representing and advising debtors, creditors, committees and post-confirmation trustees in bankruptcy cases and other insolvency or restructuring scenarios.

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